IMPACT OF SUPERFUND LENDER LIABILITY ON SMALL BUSINESSES AND THEIR LENDERS

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BEFORE THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

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SECOND SESSION

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CONTENTS

Page
Hearing held on June 7, 1990 ... 1

WITNESSES

Thursday, June 7, 1990

Bitner, William L., III, chairman and president, the First National Bank of Glens Falls, NY, and president, New York State Bankers Association ... 9
Clark, Robert, attorney, Lowe Gray Steele & Hoffman, Indianapolis, IN, representing Associated Builders and Contractors [ABC] ... 13
Egerton, Robert, president, Farm Credit of North-Central New York, representing the Farm Credit Council ... 18
Johnson, John T., president and CEO, Miners Bank of Butte, MT ... 16
Motley, John J., III, vice president, Federal Governmental Relations, National Federation of Independent Business [NFIB] ... 7
O'Brien, James P., attorney, Chapman and Cutler ... 21
Schroeder, Lee A., president, First National Bank, Dana, IN ... 4

APPENDIX

Opening statements:

McDade, Hon. Joseph M. ... 31
Skelton, Hon. Ike ... 33

Letters received for the record:

American Association of Equipment Lessors, Michael J. Fleming, president ... 139
Bank Lessors Group, the, Melanie L. Fine, Arnold & Porter ... 144
Mortgage Bankers Association of America, Michael J. Ferrell, senior staff vice president ... 155
National Association of Federal Credit Unions, John M. Stanton, chairman ... 166
National Association of Home Builders, Martin Perlman, president ... 168
National Association of Realtors, Norman D. Flynn, president ... 170
United States League of Savings Institutions, J. Denis O'Toole, executive vice president ... 172

Prepared statements:

Bitner, William L., III, with attachment ... 54
Clark, Robert ... 70
Egerton, Robert ... 81
Johnson, John T. ... 78
Motley, John J., III ... 49
O'Brien, James P. ... 87
Schroeder, Lee A. ... 41

IMPACT OF SUPERFUND LENDER LIABILITY ON SMALL BUSINESSES AND THEIR LENDERS

THURSDAY, JUNE 7, 1990

HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2359-A, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the committee) presiding.

Chairman LAFALCE. The Small Business Committee will come to order.

In 1980, Congress passed an historic piece of environmental legislation, the Comprehensive Environmental Response Compensation and Liability Act, better known as Superfund.

I introduced the first Superfund bill in Congress, which became the model for the bill that Congress ultimately enacted. The Superfund legislation grew out of a toxic waste problem in my congressional district, Love Canal, in Niagara Falls, New York.

It was Love Canal, more than any other single event, that brought the Nation's attention to the fact that no Federal mechanism existed for remediation of such a disaster, and that, ultimately, led to the enactment of Superfund.

In enacting Superfund, I think Congress did a good job of balancing environmental interests against business interests. That is why I find it so disturbing that courts, searching for deep pockets to pay for Superfund cleanups, have expanded Superfund liability far beyond what Congress ever intended.

Let me elaborate. Congress, in enacting Superfund, created an express exemption from cleanup liability for a lender that simply holds indicia of ownership primarily to protect his security interest.

This is the so-called security interest exemption.

Despite this clear legislative language, some courts, in their search for deep pockets, have held lenders liable for cleanup costs when they exercise their rights by foreclosing on their security interest. The two leading cases are United States *v.* Maryland Bank & Trust, a 1986 Federal case in Maryland, and Guidice *v.* BFG Electroplating, a 1989 Federal case in Pennsylvania.

These court decisions have held that, regardless of the amount of the loan, a lender may be liable for the entire amount of a hazardous waste cleanup if it forecloses on property that turns out to be contaminated with hazardous waste, even if the lender in no way contributed to the hazardous waste problem on the property.

In other words, a simple $50,000 loan may saddle a lender with $5 million in cleanup costs for a problem that it knew nothing about, did nothing to create, did nothing to exacerbate.

The Eleventh Circuit Court of Appeals handed down a decision in the Fleet Factors case, 2 weeks ago, which further narrows the security interest exemption.

As a result of this decision, if a lender merely participates in the financial management of a facility to a small degree, it can be liable as an owner of the facility. I fear that the day is near when the security interest exemption that Congress enacted as part of Superfund will be rendered completely meaningless by these expansive judicial decisions.

I find all this outrageous. But it is not merely the fact that courts have disregarded congressional intent and that innocent lenders are held liable that is so disturbing.

Far more disturbing is who the real loser is; the real loser is the small business community. This is the Small Business Committee and that is why today we will hear testimony indicating that lenders have stopped making loans to businesses that are located in areas of possible hazardous waste contamination and to businesses that use hazardous materials.

That's an awful lot of businesses. I am talking about well-run, creditworthy businesses complying with every facet of our environmental laws that cannot obtain the financing they need to survive because the lenders are afraid of Superfund liability.

To deal with this, I have introduced a bill, H.R. 4494, that would overturn the recent court decisions and restore Congress' original intent in enacting Superfund. In essence, my bill would bring the law back to the way it was before 1986, when courts first started expanding Superfund liability.

Specifically, H.R. 4494 would exclude lenders from liability when they foreclose on contaminated property, and thus would restore the opportunity for small businesses that use hazardous materials or that are located near contamination to obtain financing.

The bill would also exclude from liability, fiduciaries that take title to or control of property as part of a trust or estate. In no event would my bill exclude from liability a lender or a fiduciary that in any way caused or contributed to hazardous waste contamination. It is important to underscore that.

Since I introduced this most recent version of the bill in April, 118 Members of Congress have signed on as cosponsors. Within the month, we hope to change the one to two and make it 218. I like the number 218, when you have 435 Members of the House.

I find it encouraging that there is an almost even split between Democrats and Republicans among the cosponsors. We now have about 65 Democrats versus 53 Republicans—more Democrats than Republicans, but a higher ratio of Republicans to Democrats, and that is pretty good.

The bill is clearly generating support from legislators on both sides of the aisle—Democrats and Republicans, Liberals and Conservatives. Party ideologies have nothing to do with this issue.

Today, we will hear testimony from people affected by this problem. Lenders who have stopped making loans to businesses because of the threat of liability; innocent lenders who may face impairment because they may be liable for hazardous waste cleanup; and businesses that cannot obtain financing because of this problem.

Before I call upon the witnesses, however, I wonder if any members of the panel have anything they wish to say at this time.

Also, if there is no objection, I would like to put in the opening statement of the ranking minority member of the committee, Congressman McDade.

Without objection, so ordered.

[Mr. McDade's statement may be found in the appendix.]

Chairman **LaFalce**. I am delighted to have Congressman John Myers of Indiana sitting in with us on this hearing today.

John, welcome.

Mr. **Myers**. I am not a member of the committee.

Chairman **LaFalce**. Yes; that's true.

Mr. **Myers**. I have a constituent here, a fellow banker.

Chairman **LaFalce**. Would you please introduce your constituent to the committee, John?

Mr. **Myers**. I am sure the panel certainly knows this good friend of mine.

In my working life, I was a country banker, back when I worked for a living.

[Laughter.]

Mr. **Myers**. A lot of people think I should still be there.

Nevertheless, I am pleased that I was a banker and still have active interest in banking. I can tell you this, Mr. Chairman, thank you for having this meeting.

Chairman **LaFalce**. You know, when I saw you walk in, I thought you might think there was something unethical about the meeting, John.

[Laughter.]

Mr. **Myers**. I am on the ethics committee.

Chairman **LaFalce**. Yes.

Mr. **Myers**. In fact, that's where I have to go when I leave here, so I may stay here all morning.

But the thing I think most people don't realize, we are all for cleaning up the environment, but ultimately the people who are going to lose, if this law stays intact, are the borrowers.

You just can't make a loan. I come from a small town. I was a country banker. I knew where all the service stations were through the years, but I am an old timer now and some of the younger bankers coming in don't know where those possible environmental problems exist today.

In large cities—since you represent some of the larger cities—it would be impossible, so, ultimately, the borrower is either going to be paying a higher interest rate to carry the burden, or he is not going to get the loan at all.

So, the third party here, the ultimate lender, is very innocent. It is absolutely necessary to have these hearings, and I congratulate the committee.

I will introduce my good friend here, a neighbor. In fact, he is from a little town in Indiana where Ernie Pyle—some of you old timers will remember Ernie Pyle, the Hoosier writer during World War II who wrote about the experience of combat.

Now you see it on television, but back then, you only wrote about it and Ernie was from this little town of Dana, and so, this is my friend, a banker from the First National Bank of Dana, the only bank in Dana, but it is a good rural area, and certainly I recommend that his testimony be read very thoroughly.

I will read it too, even though I am not on this committee.

Thank you for giving me a chance to sit in.

Chairman LAFALCE. You are very welcome, and while I was going from left to right, starting with Mr. Motley, after that effusive introduction, I think we will deviate from it every so slightly.

Mr. Schroeder from Dana, Indiana, we are going to start with you, and then we are going to go to Mr. Motley, and go down the table.

So, let's go to Indiana first. Mr. Schroeder.

Gentlemen, if no members of the committee object, what we will do is put the entirety of your text into the record at this point in time.

Without objection, so ordered.

Therefore, you may feel free to summarize it if you so desire, or to read from it, but in any event, gentlemen, no more than 10 minutes per person because we have seven of you, and, if you all take 10 minutes, that is 70 minutes right there.

That is a while. So, Mr. Schroeder.

TESTIMONY OF LEE A. SCHROEDER, PRESIDENT, FIRST NATIONAL BANK, DANA, IN

Mr. SCHROEDER. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, as introduced, I am Lee A. Schroeder, president of the First National Bank in Dana, Indiana. I certainly welcome the opportunity to offer my views on the critical issue of environmental liability and its effect on community banks such as the one I run in Dana.

The First National Bank of Dana is located on the western border in the central part of Indiana. It is a town of about 800 people in a rural area, and there are approximately 19,000 people in our county.

Our bank is the only financial institution serving Dana and the surrounding communities. The total assets of the bank are a little over $13½ million, and we have in capital a little over $1½ million, and in loan reserves somewhat over $70,000.

Our bank, in the last 4 years, has invested in new computer equipment, software, and also in remodeling our building by doubling the floor space so as to better serve our customers.

We have been able to maintain satisfactory earnings to keep our capital within the Comptroller of the Currency's requirements. By continuing to show a profit, we help assure our customers that we will be here for many years to serve the needs of the population.

We have also invested heavily into our community by loans secured by real estate, residential properties, and small businesses. Some of our loans are also secured by farm property. We are presently loaned up to about 66 percent for our loans to deposits, and 52 percent of those loans are secured in some form by real estate.

Twenty-four percent of those loans are commercial loans. As of the end of 1989, this bank had $820,000 in loans secured by farm land, $2,931,000 in loans secured by one to four family residential property, and $1,150,000 in loans to small businesses in our community.

With the recent surge of court decisions on environmental liability, our bank has had to carefully consider what types of businesses in Dana could present liability problems.

Some of the businesses that are located in Dana that could be affected by possible environmental problems are the community's only auto body shop and convenience store which is also the only place in Dana where you can buy gas.

The other service station closed because of environmental problems and cannot be reopened because it cannot get financing.

Mr. Chairman, there are only two auto repair places in the community, and our bank does business with both. There is also only one fuel dealer in the community, and we have loaned on the property where the bulk oil storage is done. We have that financed and secured by that property.

There are two fertilizer plants in the community, and our bank has property mortgaged that is close to those plants. In addition, we have farmland, and I have no proof now that there has never been any kind of accidental spillage of chemicals on any of those farms.

As an example of how real estate value can deteriorate very quickly, a couple, who had loans with us before, requested a residential real estate loan to be secured by that property.

After examining the property, we noted that it was adjacent to a liquid fertilizer plant where chemicals have been stored. We had no choice but to deny making the loan because of possible environmental problems.

I found out approximately 1 week later that another bank also turned this loan down for exactly the same reason, and they had not discussed this with us, and had no way of knowing that we had turned it down because of the reason that we did.

There are several things that worry us here in our bank. Most of the businesses and farms that we have financed occurred some time ago before this problem became apparent. I am not so sure how we would have reacted had we known that possible environmental liability could be facing our bank.

As the only bank in the community, we are facing a double-edged sword. If we do not finance these businesses—they are all family-owned—than these people will have to close down because they cannot get financing.

Their properties, which did have a fair amount of value, could become worthless to them or to anyone else. This would hurt the economy of the entire community and surrounding area because these businesses are very much in need.

On the other side of the coin, if we continue to finance these businesses and farms, we might face an extremely costly environmental cleanup because we had to foreclose on one of these businesses, or otherwise face liability by exercising too much control.

If this happens, we could end up violating our duty to both our shareholders and the bank's depositors. This community could be jeopardized because our $1.5 million in capital could be wiped out very quickly.

The bank's relationship with the community is more than just commercial lending. We are part of this community, and I feel we do a good job of serving our community.

For example, we still make $50 loans to those people who need to buy groceries or pay a utility bill until their social security check arrives. We do not charge service fees to community organizations, even though they may have only a few dollars in their account.

We allow groups or organizations to use some of our facilities such as a meeting room or to use our copier without charge, and many of our staff are involved in voluntary organizations, and we encourage them to do so, even if it takes some time out of their banking day.

I know there are hundreds and hundreds of banks like ours across this Nation that face this problem—trying to keep their communities from losing small businesses. If, however, banks are unable to finance those businesses because of unforeseen environmental problems, then not only will small businesses fail, but so, eventually, will the banks.

It will not be long before the towns themselves will deteriorate and cause an ever-growing economic problem for this country.

Our bank has begun to evaluate its loans for environmental problems. We have not yet finished the project, and I am not sure what our final decision will be on our loans that may have potential environmental problems that are more than we currently think.

We do not turn our backs on our neighbors, and I don't think that is what we want to do in the future. However, this result could be forced upon us because of the possible environmental problems that we might face.

Our loans have historically been very sound, and we do not foresee any foreclosures in the near future. However, I am not so sure that we can rely on that philosophy with ambiguous laws and with examiners taking into account the collateral of our loans.

I have personal knowledge of the farmers and the small business owners of this community, and I know that they are all environmentally conscious of the rules and regulations, and none of them would purposely pollute the land.

No matter how careful someone is, there is always the possibility of an accidental environmental damage to farm land.

As you know, Mr. Chairman, in the past decades it was not uncommon to have dumps in rural areas because of the lack of public landfills. Many of those dumps have been covered over with good topsoil and are now being farmed.

There is no way to tell where these dumps are located and whether they contain toxic wastes. I know that environmental tests can be done to see if there are any environmental problems on real estate. However, the cost of checking farm acreage is prohibitive to the farmer.

We have residential property selling from $20,000 to $45,000 in our community, and I doubt if any of these people could afford an additional $2,000 or more to have their property tested for environmental purposes before closing.

Most importantly, I don't think we have anyone in the area who is qualified to do the testing. There may be someone in Indianapolis which is 75 miles away, but I don't think we could afford to have them come clear out to Dana, Indiana to do these types of tests.

In conclusion, Mr. Chairman, I spoke with an officer of a rather large corporation a few days ago about this very problem and the fact that I had been asked to testify before this committee.

He asked me, playing the devil's advocate, why should we, as citizens, be concerned about banks and their problems? When I explained to him that it was not a matter of saving banks and their shareholders, but saving the small businesses and the communities, whether large or small, and allowing banks to continue to finance those small businesses, he realized how important this matter was to everyone.

A great percentage of banks are themselves small businesses owned by local shareholders. These shareholders can ill afford to lose investments that they have made in community banks across our Nation.

If these banks continue to be exposed unfairly to environmental liability, they will be forced out of business. Without local banks, who can they turn to?

I would be happy to answer any questions.

[Mr. Schroeder's statement may be found in the appendix.]

Chairman LaFalce. We will refrain from asking questions until we hear from all the panelists, and that will be some time.

Thank you for your excellent statement.

If anything, I would just point out that it is probably going to cost a lot more than $2,000, a lot more, and it is going to take a long time.

I have a problem in the Rochester area of my congressional district, and I have asked DEC to make a thorough environmental assessment of this real estate in order to start up some loans.

I made this request in the summer of 1988, and they are still working on it—2 years—and we still don't have an answer from DEC.

Then, of course, if you have a private sector person do it, and then the bank relies on the private sector, and you are sued, and you're liable, you are going to sue the person who did the test for malpractice or something, and his insurance rates are going to go up. They are going to skyrocket.

This is a real snow-balling problem. There are other aspects to it. But let's hear from the witnesses and go in order.

Let's start with the State of Rhode Island, Mr. Motley, NFIB.

TESTIMONY OF JOHN J. MOTLEY III, VICE PRESIDENT, FEDERAL GOVERNMENTAL RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS [NFIB]

Mr. Motley. Thank you, Mr. Chairman and members of the Small Business Committee for the opportunity to testify today on H.R. 4494 which has become known as the Superfund Lender Liability Act.

NFIB and its 550,000 members are very concerned about this.

I also want to thank you for calling the small business community's attention to this potentially disastrous problem. Usually, I am very skeptical, as are other members of the small business community, about industries that like to point to the small business aspects of their problems. In effect, they do this to get the small business community out in front to see if they can get some redress from Congress because small businesses are extremely popular.

But in this particular case, we see a direct relationship between the——

Chairman LaFalce. If we just recognize the clout of the NFIB, Mr. Motley. That's what it is.

Mr. Motley. There is a direct relationship, Mr. Chairman, between lending and small business.

I guess it wouldn't be too extreme to say that capital is the life blood of small business. It is essential during all phases of a business' life, from startup until the time the owner decides to sell it or hopes to sell it and get out of it. Obtaining capital from traditional sources or borrowing from banks is definitely the largest single source of capital or financing available to smaller businesses.

Anything that threatens a steady, reliable, and affordable flow of capital, I think, threatens the very life fabric of small business in this country.

As you mentioned in your opening statement, recent court decisions have made some changes or broadened the liability under the Superfund Act to include innocent secured parties, particularly and primarily banks, as being liable under the act.

We believe that this indeed threatens small business.

Banks, in turn, in order to protect themselves, have begun to restrict credit and to raise the cost of credit for those people who have potential Superfund cleanup or other environmental problems.

As I mentioned before, this really has an effect on small business in all phases of its operation. A second leading source for small business startup financing is debt financing from banks.

Small businesses borrow continually from banks for operating capital and for growth capital. For growth capital, you need longer-term loans. Even when a small business owner is looking to get out and to sell that business, the bank is involved again.

So, it really does have a tremendous impact, and we have heard from NFIB members across the country that they are beginning to feel the brunt of this problem.

The impact is very broad. It does not affect just the chemical firms, the plastic firms, the plating firms, and the foundries that you would expect to have a lot of difficulty with the Superfund Act.

It also affects, as we heard, the gas stations and any small business that might have some sort of a tank in the ground. Those who have very small fleets, the electricians, the plumbers, the contractors who are out there.

So, the impact is very broad, and it is across-the-board.

Your bill, Mr. Chairman, would return the assessment of liability to the original intent of Superfund where we believe it should be.

You know how we set our policy? NFIB polls its members, and we have polling data indicating that not only does our membership want stronger environmental laws, such as the recently passed

Clean Air Act, but, also, they strongly support the principle that polluters should pay.

Therefore, we are very, very happy and delighted to support you with H.R. 4494, to work with you to try and obtain a minimum of 218 cosponsors and more, if we possibly can, and then to work with you and the rest of the Congress to see that the bill is enacted into law.

Thank you.

[Mr. Motley's statement may be found in the appendix.]

Chairman **LaFalce**. Thank you very much, Mr. Motley. Our next witness will be the president of the New York State Bankers Association, Mr. William Bitner.

Mr. Bitner.

TESTIMONY OF WILLIAM L. BITNER III, CHAIRMAN AND PRESIDENT, THE FIRST NATIONAL BANK OF GLENS FALLS, NY, AND PRESIDENT, NEW YORK STATE BANKERS ASSOCIATION

Mr. **Bitner**. Good morning, Mr. Chairman and members of the committee. I thank you very much for the opportunity to testify this morning as I am the president of the First National Bank of Glens Falls in Glens Falls, New York as well as being, currently, president of the New York State Bankers Association which is the trade association which represents all of the commercial banks in New York State, be they community banks, regional banks, or the money center banks.

Mr. Chairman and members of the committee, the issue of environmental liability under the Superfund is a critically important issue to New York bankers. It is important in our capacity not only as lenders, but as corporate fiduciaries as well.

We certainly appreciate and support your efforts to provide reasonable relief for banks and businesses from the potential unlimited liability and operating difficulties that we have been experiencing in the wake of the Superfund legislation and the many court decisions which have interpreted the law since that time.

New York State Bankers Association strongly supports H.R. 4494. We also note that many other trade associations, including the American Bankers Association, have identified this issue as a top priority.

We believe that H.R. 4494 reflects the intent of the Superfund law and its 1986 amendments, as they relate to bank's liability for environmental cleanup, when the bank did not do anything to contribute to contamination.

With the committee's permission, I would like to give you some examples of some problems we've experienced in New York State and to relate to those, and I will start, if I may, with an example from my own bank.

We are a bank of about $600 million in assets in northeastern New York, and we have had, for some time, a customer who had a reclamation center at the time in the early 1980's when the price of certain materials fell back.

This particular business suffered some reversals that resulted in judgments and liens being filed against the owner.

Now, we worked diligently with this borrower to reorganize his debt and to enter into several consolidations and extension plans in order to solve the problem.

Initially, the borrower had a savings account securing his loan, which made it good as gold. But as he needed additional capital to go forward, the only thing left, of course, was a mortgage.

I think good fortune developed in one sense, but bad fortune for the business in another sense, as a member of our board of directors, who was a former environmental commissioner for New York State, Bob Flacke, advised that taking a mortgage on a junk yard was not a smart move.

We were not at all up-to-date on the problems that this would represent, and so, at that point in time, we had to deny this borrower additional capital to go forward, and it has put this business into chapter 11. It is a very serious problem.

Other examples, the First National Bank of Long Island, about a $200-million bank in Nassau County, made a $1-million loan to a real estate holding company located in their county.

The loan was collateralized on a first mortgage on a very large factory building—42,000 square feet. It had a 12-year maturity on the loan, and the bank was notified in 1989 that it was the intention of that business, that factory, to move.

Soon after they were notified—now this factory is located on an industrial park where there are a total of 100 other businesses there—that the entire site is an inactive hazardous waste site and has produced some significant ground water contamination.

The factory had nothing to do with this. They were not a contributor to this, and the contamination is now designated as an area of significant threat to public health. Obviously, the bank contributed nothing to this problem.

The fact is that the factory is now moving, and the bank stands to lose its collateral or be forced to take over collateral on a piece of property which may be worthless, and a million dollar loan which is paid down perhaps to $940,000, the bank could very easily suffer a loss on the entire amount.

If the Superfund law were amended to limit or eliminate the liability of cleanup, the bank would certainly be in a much better position to collect or to foreclose in this particular situation.

Another example is a bank in the central part of New York, State Bank of Chittenango. It is a very small bank, smaller than $25 million. The bank holds a mortgage on real estate which contained a residence, another building were compounds were used in the dye industry.

The original loan was made back in the 1970's and was $50,000. The borrower was a chemical company and unfortunately the business failed. The bank took the loss in December 1980 and, 3 years later, had to take ownership of the property because of past due taxes. They paid another $12,000 out in taxes and took ownership of the property.

The property has now been designated as a contaminated site, and the bank has spent nearly $80,000 in consulting fees in an effort to correct the problem, so I would like to find that $2,000 attorney again.

Chairman LaFalce. Yes.

Mr. **Bitner**. Legal fees, testing costs, and cleanup charges, and it has not been cleared up as a bank liability.

In addition, the bank has agreed to a definitive merger agreement with another bank, but cannot go forward in the merger. The bank, trying to acquire the State Bank of Chittenango, has spent nearly $100,000 in trying to clarify this problem, as a testing site.

I would like to tell members of the committee that numerous samples of soil and water taken from the site and the adjoining properties have been tested for the various hazardous wastes that were suspected, and, to date, everything has proven to be negative.

However, the entire thing is stalled. The merger and the loss, of course, to a small bank like that is not inconsequential.

Needless to say, the bank has grown very cautious about making loans to any business where chemicals or any other hazardous waste material might be involved. This caution would, of course, include gasoline stations, manufacturing plants, and very well may be extended to farm loan applications, and plants, and nurseries where fertilizers have been used.

In 1986, the Marine Midland Bank was asked to be the lead bank in a leveraged buyout of a corporation, a local industrial solvents manufacturer and metal processor located in western New York. The financing would have been $50 million.

However, because of the CERCLA considerations, an environmental audit was deemed necessary. The cost of this audit was $250,000. It forced Marine Midland to have to back out because the borrower could not absorb this cost, and the bank could not absorb it, and the loan would cease to be a profitable undertaking.

Now, I would like to turn, if I may, for a moment, to the fiduciary concerns.

Banks serve as corporate executors and trustees, and the problems under the Superfund law are substantial and present difficult business and operational challenges.

There is a delay because a bank can't accept the appointment of a trust or estate while they determine whether there is a necessary cleanup or environmental problem. It is the liability for the cleanup that the bank may suffer, and the liability of the trust and the State beneficiaries.

A situation occurred when a bank in western New York accepted an appointment as the trustee. I cannot identify the bank because they have asked not to be identified. The bank accepted an appointment to be the trustee, and it was about a $1-million estate, and thus far they have spent $125,000 to clean up the problem.

Chairman **LaFalce**. In the written testimony——

Mr. **Bitner**. Sir?

Chairman **LaFalce**. You say Lockport, New York. You get pretty close to home.

Mr. **Bitner**. I know. It is not by accident that we mention that, Mr. Chairman.

[Laughter.]

Mr. **Bitner**. We need the other 100 Congressmen who have not endorsed H.R. 4494. Maybe we can get examples close to them, the other 100 Congressmen.

In this particular situation, well, you can say all right, the bank had to spend 12½ percent of the estate to clean it up, but they face other problems. Supposing the beneficiaries come back and sue the bank, and say they could have gotten this done for $50,000, or for some other dollar number, or the $125,000 is not adequate. Maybe it is not totally cleaned up.

The liability to the bank as a fiduciary is still out there, and the liability is a very serious one.

Delays in whether they could accept the estate is another thing that causes chaos because, obviously, the beneficiaries want this matter resolved as quickly as possible.

The problems in these areas are not inconsequential. The Manufacturers Hanover Trust Co., probably one of the five or six largest U.S. banks, acted as an executor in an estate where they had a very valuable piece of commercial property located in Long Island, originally valued at $2½ million.

In the process of selling the property, the tests showed that there were acetates used in producing certain products there, and the clean up expense, including the environmental, legal fees, engineering, carting, excavation, et cetera, was over $1 million.

Again, the assets of the estate were sufficient in that case because they had $2½ million, but if they did not have an estate that large, if they did not have something sufficient, the bank would have had to bear whatever excess costs were involved.

In conclusion, these examples point out the first-hand legal and operational problems that commercial banks are experiencing in complying with the Federal Superfund law. We feel the results are not intended by the Congress when a bank forecloses on collateral to protect its security interest on a loan or serves as a corporate executive or trustee in those capacities, that did not contribute to environmental contamination.

I echo what you said in the outset. We are not trying to dodge responsibility, but we are saying, if we had nothing to do with it, why are we being forced to pay for it?

We strongly support your efforts to provide relief to the banks from this onerous and inequitable burden we continue to experience under the Superfund law. We appreciate your efforts in urging your colleagues to pass H.R. 4494 and hope that you can get an additional 100 or more sponsors.

We will do what we can to assist you in this area.

The New York State Bankers Association has previously provided you a draft of legislation which merges some of the concepts we discussed with you during a recent meeting. Our draft takes into consideration issues raised during our discussion as well as some of the provisions contained in Senator Garn's related bill, S. 2319.

We urge you to consider our proposal as well, during the committee's consideration of this important issue, and we request that a copy of our proposal be inserted into your record.

We look forward to working with you, and the members of this committee, and our New York congressional delegation on this most important and critical issue.

Thank you.

[Mr. Bitner's statement, with attachment, may be found in the appendix.]

Chairman **LaFalce**. Thank you very much, Mr. Bitner.

Our next witness will be a representative of the Associated Builders and Contractors and that representative is Mr. Robert Clark, an attorney of the law firm of Lowe Gray Steele and Hoffman, also from Indianapolis, Indiana.

Mr. Clark.

TESTIMONY OF ROBERT CLARK, ATTORNEY, LOWE GRAY STEELE & HOFFMAN, INDIANAPOLIS, IN, REPRESENTING ASSOCIATED BUILDERS AND CONTRACTORS [ABC]

Mr. **Clark.** Thank you very much, Mr. Chairman. Thank you, sir.

Mr. Chairman and members of the committee. My name is Robert Clark. I practice environmental law in Indianapolis with the law firm of Lowe Gray Steele and Hoffman. As head of the environmental law section, I am here today to discuss my concerns on this issue not just for the financial community, but for a segment of the small business community which depends greatly on reasonable access to capital financing, that is, the small businessmen and women who are builders and contractors.

My firm is a member of and represents the Associated Builders and Contractors in Indiana. Contractors are pretty clearly second tier players in this problem, but as I think all the witnesses have pointed out, they are clearly affected nonetheless, as are all small business people.

When environmental problems arise with regard to a commercial site, and the financing falls apart, can't be obtained, or is rescinded, more than the lender, buyer, and seller are affected.

Often it is the contractor who has agreed to build the project for the buyer or developer who also loses. Unfortunately, that contractor may be the person who loses the most.

Although reasons of privilege keep me from discussing fact-specific cases, I can relate to you some scenarios which will illustrate for you, I believe, the dimensions of this problem.

Let's assume that a developer wishes to purchase a piece of property for development as a small industrial park or retail strip center. The developer will sign a purchase agreement with the seller and will obtain a financing commitment from a lender to finance the construction of the project.

The permanent financing on the construction has not yet closed. Among other things, the permanent financing is conditioned on the receipt of a favorable environmental assessment.

In the meantime, the developer contracts with a general contractor for the construction of the buildings and site preparation. In the real world, the contractor is often requested or, frankly, pressured by the developer to begin construction prior to the final approval of the construction loan. The developer wants to get going on his project, and also the contractor will do pretty much what the developer wants.

Contracting jobs have tight time schedules, often with penalty clauses in their contracts. Construction projects are time-sensitive and very competitive.

Should the contractor decline to begin work before the final financing is in place, he is going to find his job in the hands of one of his competitors. So, he begins the work. He dedicates his time, his resources, and he enters into contracts with subcontractors.

In some cases, he may even need to secure financing for extra equipment or supplies. Then the environmental assessment report is returned, and it reveals that a very small portion of this site was once contaminated with PCB fluids.

Although that portion of the site has been cleaned up to everyone's satisfaction, including State, Federal, and local environmental authorities, the lender refuses to proceed with the loan because of his concern for CERCLA liability.

PCB's are an obvious case of an environmental hazard. However, I can tell you situations in which lenders have pulled out for less severe reasons. Leaking underground storage tanks and concerns over the handling of waste oil come to mind.

The result of all of this is that the owner now has no money to pay the contractor. The contractor, therefore, becomes the biggest loser. He loses his profits on the job, and, because he dedicated resources, he must absorb the loss of funds invested outright. He has no place to turn until another job comes along.

Equally significant, perhaps even more significant, his employees have no work, and his subcontractors and their employees have no work. If the contractor is a small business or perhaps an operator of a gas station or dry cleaner seeking to expand, that business will then be curtailed.

Because contracts have been signed, the potential for litigation is great, and additional dollars are spent either attempting to negotiate a settlement or an arbitration.

What I have just described is an actual construction industry scenario. I suspect it happens more often than we care to know. It is a tragedy, in my judgment, not only for the lender and the borrower, but also for the small business contractor, his employees, and their families.

I do not fault the bankers in this situation. Environmental assessments are commonplace, and, indeed, I routinely recommend to all of my clients involved in any commercial or industrial land transaction, that those assessments be done.

The problem is the consequences of those studies and the conclusions being drawn from them are the cause of a very serious issue. Bankers and lenders make very prudent decisions in not proceeding with loans which might expose them to CERCLA liability.

Unfortunately, the bottom line is construction and other small businesses in general are denied the necessary capital.

In my judgment, the current legal interpretations of CERCLA by the courts on the lender liability issue have placed the lender in the position of the owner. We believe this is wrong.

I know of no commercial lender who wants to be an owner. More importantly, I know of no small businessman who wants his banker to run his business for him. CERCLA, however, has put the lender in the untenable position of being liable for his customer's hazardous waste practices and other environmentally sensitive practices.

The lender becomes, at a minimum, as a result, much more cautious and conservative in his or her lending. This results in the cost of a typical financing being increased as much as $10,000 or more, and, as an aside, I would suggest to you that the bankers are not the ones who absorb the cost of the environmental assessments in those cases. It is the small businessman who does.

This results in closings being delayed, canceled, and the ripple effect hitting all small businessmen, including contractors.

As mentioned by you, Mr. Chairman, in your opening remarks, the need for legislation such as H.R. 4494 has been brought home by a recent decision, a case out of the Eleventh Circuit Court of Appeals, the Fleet Factors case.

In that opinion, the court held that a lender was liable under CERCLA because of the lender's participation in the financial management of a facility to a degree which indicated the lender's capacity to influence the owner's treatment of hazardous waste.

Now, I know that's confusing.

Chairman LaFalce. The capacity is not confusing, it is very clear. Anybody just about has the capacity to influence.

Mr. Clark. Precisely my point, Mr. Chairman. If that lender participates——

Chairman LaFalce. Any lender; yes.

Mr. Clark. If that lender participates in financial, not even operational management of a facility to the extent that it could affect—not necessarily does, but could affect—hazardous waste disposal decisions, there will be liability to the lender under that opinion.

The lender with the mere authority to influence the decision regarding waste practices can now be held strictly liable under CERCLA.

If we take this case to its logical extreme, this means that virtually every lender can be held liable under every secured lending situation.

I am relatively confident that this decision has sent some pretty serious tremors through the financial community. I am equally convinced that it will not only tighten credit availability for developers and contractors and other small businesses, but it will make what credit will be available, much more expensive.

We support you, Mr. Chairman, in your efforts to bring some rationality and reasonableness to this issue. H.R. 4494 is a very sound piece of legislation. It is, we believe, a reasoned approach to the solution of a difficult problem which affects small businesses everywhere.

Thank you for this opportunity to address your committee on this matter, I will be happy to respond to questions later.

[Mr. Clark's statement may be found in the appendix.]

Chairman LaFalce. Good. We will go on to our other witnesses before having questions.

You mentioned the Fleet case.

Mr. Clark. Yes.

Chairman LaFalce. Let me point out that the legislation that I have drafted in early 1989, and then I refined in 1989, was done before the Fleet decision, and so, it does not yet reach the problem created by Fleet which is potentially much more significant than the past decisions.

We can't be changing legislation every single day. All our efforts are going to be to gain cosponsors for H.R. 4494, realizing that at the time we get to legislative consideration of a bill and the subcommittee, committee, floor consideration, conferences, et cetera, refinements will have to be made based upon the most recent court decisions as of that time.

But I don't want to start changing the process, changing the bill every single time that it becomes obvious that we need a little change here or a little change there because of this court decision or that court decision. We would go spinning off in 435 different directions.

We have to be on one direction now, and that direction is clearly the courts have been too expansive in interpreting CERCLA. They have aborted congressional intent, and the message of H.R. 4494 is return to original congressional intent.

Well, having hit Indiana, Rhode Island, and New York, let's now go to Butte, Montana, and we will have Mr. John T. Johnson now testify.

Is there an army post in Butte, Montana, and what is the name of it?

Mr. JOHNSON. There is none in Butte but one in Great Falls, Montana, Malmstrom Air Force Base.

Chairman LAFALCE. Yes; go ahead.

TESTIMONY OF JOHN T. JOHNSON, PRESIDENT AND CEO, MINERS BANK OF BUTTE, MT

Mr. JOHNSON. Mr. Chairman and members of the committee, I certainly appreciate the opportunity to tell you the story that my small bank finds itself in.

As you said, Mr. Chairman, my name is John T. Johnson. I am from Butte, Montana, and I am president of Miners Bank of Butte, which is a financially sound, small, commercial, rural bank with total capital of $2,500,000.

In 1980, our bank extended a $200,000 working-capital loan and a $275,000 SBA-guaranteed term loan to Montana Post and Pole, a telephone post and pole treatment company located in Butte.

Due to changes in Federal logging regulations, Montana Post and Pole was unable to remain in business. The company defaulted on its loan to the SBA and to Miners Bank in early 1984.

In June 1984, with the assistance of the Small Business Administration and with the concurrence of the owners of Montana Post and Pole, Miners Bank foreclosed on a portion of the plant site owned by Montana Post and Pole Co.

The bank then wrote off the debt. After realizing that the property was worthless, and with the acquiescence of SBA, Miners Bank returned the deed to the owners of Montana Post and Pole in September 1984 and released all its claims to the real estate.

The deed to the bank was never recorded, and, as a result, Miners Bank contends that title to the property never actually transferred to the bank.

Even so, and on the basis of the bank's alleged and doubtful 3-month ownership of a portion of the plant site property where the bank just acted to protect its security interest in 1984, this past February—some 6 years later—our bank was one of three parties named as a PRP or potentially responsible party by the EPA and the State of Montana on the Post and Pole site.

The truly responsible party, the owners and operators of Montana Post and Pole are virtually judgment-proof. The other PRP is one of America's largest corporations, Arco. We believe that the State and the EPA expect Miners Bank to pay a substantial portion of the total costs of cleaning up the Montana Post and Pole site.

The precleanup costs on the site are projected at $1,200,000. The actual cleanup costs at the site are projected to be about $8,750,000. The total bill for the cleanup, therefore, will be about $10 million.

If Miners Bank is forced to pay one half of just the precleanup costs at the site, or $600,000, the bank's capital will be impaired and the bank will, to use a banking term of art, be under close regulatory scrutiny.

If the bank is forced to pay as much as $1,500,000 in this process, the bank could be judged to be insolvent by the regulators. The bank simply does not have the resources to pay even a substantial portion of the cleanup costs. As I stated, our total capital is only $2,500,000.

In 1984, our bank used environmentally acceptable loan management practices. For example, the description on the deed given to the bank was for a portion of the site that we believed was not contaminated.

We worked closely with the SBA, and, under its direction in handling this problem SBA loan, we attempted to act prudently.

The management practices that were acceptable 6 years ago now appear to be the death knell of many small banks and small businesses across the United States.

In fact, 3 weeks ago, we turned down a loan from a customer who handles hazardous products because it was too risky for us to do.

I want you to know that as a PRP, our small business has paid out over $100,000 in legal and technical support expenses since February 1 to defend itself in this matter. This expense, which is ongoing, will severely impact this year's earnings.

Counsel tells me that in a major judicial decision rendered just last week, the Eleventh Circuit Court of Appeals said that congressional, legislative history on innocent lender liability is, at best, sparse.

I ask you this question, gentlemen: Is it the intent of Congress to bankrupt innocent small businesses, including innocent small banks, in the name of cleaning up a waste site when those innocent businesses had nothing to do with polluting the site?

If so, small banks cannot risk lending money to many small businesses. This will be particularly true if Federal loan guarantee agencies, such as the SBA, are exempted from liability but small banks are not.

I join the courts in seeking your clear direction in this matter.

[Mr. Johnson's statement may be found in the appendix.]

Chairman LAFALCE. Thank you very much, Mr. Johnson.

Let us now hear from Mr. Robert Egerton, speaking on behalf of the National Farm Credit Council.

Mr. Egerton.

TESTIMONY OF ROBERT EGERTON, PRESIDENT, FARM CREDIT OF NORTH-CENTRAL NEW YORK, REPRESENTING THE FARM CREDIT COUNCIL

Mr. **Egerton**. Good morning Mr. Chairman and members of the committee.

My name is Robert Egerton. I am president of the Farm Credit Association of North-Central New York, a farmer-owned credit institution which has 2,000 farm loans in eight counties in central and northern New York State.

Presently, our loan volume is $105 million.

I am also representing other farm-credit lending institutions within the Springfield district and, as you mentioned, the National Farm Credit Council, which is our trade association.

I am here to express our collective view relative to lender liability under the Superfund law.

By its very nature, Mr. Chairman, farm lending is a risky business. Commodity supply and demand imbalances leading to large fluctuations in price, weather, disease, and related unforeseen problems can often create financial problems for the borrower and for the lender, if not adequately protected.

These are problems that all agricultural lenders expect to deal with, and, to a great deal, anticipate, or try to plan for.

The potential for unforeseen and unlimited liability under CERCLA, however, is a risk which is very difficult to deal with except through the denial of credit. What is of particular concern is the significant cost from environmental cleanup following changes in previously approved practices, even though all the laws were followed at the time.

An excellent example that I will use is the cost that is presently incurred for federally mandated asbestos removal which was an approved and, in fact, recommended or required insulating material 25 years ago.

Such is the case also with many agricultural chemicals which were, at one time, approved for farm use. Property which has been contaminated can easily turn out to be an environmental time bomb, even after a lending institution has sold the property, with the cost of cleanup far exceeding the value of the property itself.

Mr. Chairman, the Farm Credit system supports the environmental cleanup mission of CERCLA, and I want to make that very clear, but its enforcement efforts are misdirected at lenders who are not equipped for or in a position to monitor or enforce compliance with environmental laws.

It appears that lenders are viewed as deep pockets and the source for funding cleanup costs. Mr. Chairman, I know of many examples of farm mortgage loans which would have been made except for the concern over the possible contamination of the property.

I also know of situations in which Farm Credit sustained significant financial losses due to a delay of foreclosure or by not exercising their rights to foreclose due to concern over unlimited liability under CERCLA. I would like to highlight this morning seven examples, if I may.

A few years ago, one New York Farm Credit association foreclosed on a large fruit farm. Subsequently, a pesticide storage building with a leaking roof was found on the property.

Before the parcel could be sold, the material, including not only what was in the building, but shavings from the wooden beams and soil from the barn floor, had to be removed and disposed of.

Disposal of the material so far has cost over $60,000, and the association has set an additional $200,000 aside to defray costs of additional cleanup, even though the association no longer owns that property.

The buyer of that farm required this as a condition of purchasing it.

In the Midwest, a lending association made a loan secured by a farm. After the loan was made, a stream running through the farm was found to be contaminated with PCB's from a nearby chemical plant.

Neither the borrower nor the lender were at fault. For unrelated reasons, the borrower defaulted on this loan, and the lender opted not to foreclose due to CERCLA liability as the estimated cost of cleaning up the property far exceeded its value.

In that instance, we compromised a $200,000 debt.

One association recently received a loan request from a farm borrower who wanted a mortgage loan to defray the cost of disposing of several barrels of waste found illegally dumped on his property without his knowledge.

The association opted not to make the loan due to potential liability. In this case, there was liability without fault, and the potential for unlimited liability prevented a responsible citizen from cleaning up a problem for lack of sufficient credit. A few years ago, such a loan would have been made.

During the course of a lengthy foreclosure proceeding on a 188-acre farm, rumors indicated that the farm's water supply was contaminated. The association was forced to consider whether to walk away from its $170,000 investment in the property or run the risk of being liable for a toxic cleanup where the ultimate cost was unknown.

The foreclosure sale was postponed for 6 months while the necessary research was conducted. The association did eventually proceed with the foreclosure and subsequently we resold the property, but the delay cost the association several thousand dollars in interest costs, legal fees, and labor costs to fully assess the business risk in ownership of the property.

At the end of a protracted bankruptcy and foreclosure case of a large dairy farm, also in my association, the owner delayed the foreclosure sale by hinting that the farm's water supply might be contaminated from nitrates from fertilizer on adjacent fields.

The potential cleanup costs could be significant. How do you, for example, clean up years of nitrate buildup in crop soils?

After detailed investigation revealed that the water was fit for consumption, we did buy the farm at foreclosure and subsequently resold it but incurred the added costs for testing for contamination as well as delays experienced on this.

I will point out that the buyer of that property has since put in a new water supply.

One farm credit association received a loan request from a small farmer for a mortgage. A walkover assessment was done, and no obvious signs of contamination were noticed.

Later, the farmer was found by the State environmental agency to have been allowing refuse to be dumped on the land.

The loan was never booked, but the Farm Credit could have been liable for cleanup had it booked the loan and eventually taken title to the property even though there was no evidence of dumping when the assessment was made.

As my final case, a local association is about to foreclose on a $450,000 farm loan where the property is located adjacent to a junk yard. Presently, we are checking the property to determine if we might opt not to take title, just in order to avoid liability under CERCLA.

These examples illustrate, Mr. Chairman, the increased financial hazards associated with farm lending in light of environmental liens and liability concerns.

Making the lender the environmental enforcer has the following adverse consequences.

The role is unfair to the lender as his or her business is credit.

The courts are turning the without-fault liability theory of CERCLA into a lender's liability lottery in which a lender is unable to predict when or if liability will attach which ultimately results in a restriction of credit availability.

Third, the cost to lenders generated by monitoring compliance and environmental liability are passed on to borrowers in the form of increased interest rates, so many innocent borrowers pay for those who are guilty.

I should point out that even the so-called guilty parties may, in fact, have done nothing wrong, though they are held responsible. They may have simply been caught in changes of regulations or from proximity to environmental lawbreakers over which they had no control.

In addition, lender's liability for environmental laws is, as I mentioned, restricting credit to creditworthy applicants in situations where environmental problems are merely suspected and in cases where credit may be the only sources of cleanup.

A lender's decision to take title to property often rests on the quality and reliability of environmental consultants' reports. Consultants are unregulated, and through mistake, testing errors, or inexperience, lenders can be innocently held liable.

Often then, the best course of action where there was a suspected problem is to walk away from the collateral or not make the loan.

In conclusion, Mr. Chairman, the Farm Credit System institutions support your legislation H.R. 4494 to limit Superfund liability of financial institutions and restore the opportunity for farmers and other small businessmen located in areas of possible hazardous waste contamination to obtain loans.

We agree that all citizens must be good stewards of the environment, but the cost of cleanup resulting from a change in regulations or from contamination beyond the control of the property owner or lender should be borne by all of society.

A recent study commissioned by the New York State Legislature on credit availability found that there are problems with the availability of credit in many rural areas of New York.

The increased risk to a lender under CERCLA will likely exacerbate an already difficult situation and further hamper progress in rural development.

Thank you again for introducing H.R. 4494 and for the opportunity to express these views this morning on behalf of the Farm Credit System.

[Mr. Egerton's statement may be found in the appendix.]

Chairman **LaFalce**. Thank you very much. It should be quite obvious that there is a tremendous potential problem in the agricultural sector, something that we will have to bring to the attention of the rural caucus.

Now, let's go to Chicago, Illinois, Mr. Jim O'Brien.

TESTIMONY OF JAMES P. O'BRIEN, ATTORNEY, CHAPMAN AND CUTLER

Mr. **O'Brien**. Good morning, Mr. Chairman and members of the committee. My name is James O'Brien, and I am a participant in the Chicago office of the law firm of Chapman and Cutler.

Chapman and Cutler represents a number of banks and institutional lenders in secured lending transactions.

As an environmental lawyer, I am frequently called upon to help our lender clients evaluate and try to address environmental risks in secured lending transactions.

I have had the pleasure of serving as editor and an author of Environmental Due Diligence: The Complete Resource Guide, which is a 500-page book which addresses the issues before the committee today.

I think the page count is significant only in the sense that the problems and issues we're addressing would deserve such treatment.

I appreciate the opportunity to provide my testimony to the committee about the significant impact of Superfund on secured lending.

Environmental liability is a matter of utmost concern to banks and institutions which lend money to businesses and, in particular, to small businesses. Enormous amounts of time, effort, and money are spent on environmental due diligence in financial transactions, and by environmental due diligence, which is really the shorthand in the industry, I mean the process of investigating, and evaluating, and addressing the environmental issues in a transaction.

As the law now stands, the only way a bank can protect itself from liability through foreclosure as an owner is to satisfy the innocent land owner defense. The defense requires lenders to undertake "all appropriate inquiry" to find the contamination.

EPA's interpretation of that defense and other aspects of the statute, and the court decisions which construe it, however, are not consistent with the intent of Congress at the time of enacting Superfund.

Indeed, environmental lawyers in the Government have likened the search for an innocent landowner to that of Diogenes in the daylight with his lantern. If the lender undertook all appropriate inquiry, and the contamination was found, then the lender was not an innocent landowner. If the lender did not find the contamination, then all appropriate inquiry was not made.

The result is a chilling effect on lending to businesses which are environmentally active and who do not have the money to spend on elaborate environmental due diligence. The risks also with lending to a small business from environmental matters are no different than the risks associated with large lending transactions. It really is just a matter of adding zeros.

In preparing the environmental due diligence book I spoke of, we surveyed lenders who were a party to almost 300 multimillion-dollar transactions in 1988. The survey revealed that lenders believed that 70 percent of those transactions were environmentally risky, and, although the lenders identified a variety of different environmental risks, all lenders surveyed identified environmental liability for cleanup costs as owner through foreclosure as a top environmental risk.

All of the lenders surveyed used environmental audits or property assessments to address the problems of environmental risks, the costs of which, according to that survey, ranged from $1,500 to $25,000, and averaged $4,500.

Based upon those survey results, we projected that approximately $418 million will be spend on environmental audits for environmentally risky transactions through the 1990's.

In other words, in addition to all of the other costs and fees that are typically charged to borrowers in a transaction, lenders are going to charge borrowers over $400 million simply to provide comfort on these kinds of environmental risks.

You probably will not be surprised to hear that this issue has created a new industry of environmental consultants performing assessment or audits. You may be surprised to learn that it also has created a new legal specialty.

Recently, I had breakfast with a Washington lawyer who described himself as an environmental due diligence lawyer. Almost all of his practice and that of other lawyers in his firm, involved environmental due diligence issues in financial transactions.

Can the small businesses in this country support the growing legal and consulting business in environmental due diligence? I certainly suggest not. A small business borrowing $100,000 hardly can afford to pay $4,500 for an environmental assessment. Moreover, that is assuming the lender is willing to loan the money on any terms.

My testimony today is directed at the legal issues associated with Superfund liability for lenders. I have summarized my rather lengthy testimony into really, I think, three issues that impact on secured lending from environmental liability.

The first is that the court decisions in this area are confusing; they're inconsistent, and most of them, certainly do not reflect congressional intent.

For example, one case has stated that Congress intended, in passing Superfund, to hold secured lenders liable. In another case, however, the court said that even becoming an owner through foreclosure is not enough, and that Congress intended some sort of control in order to become an owner through foreclosure and incur environmental liability.

At best, we see that the courts certainly do not give lenders any sense of certainty on environmental issues, and, most probably, the decisions misconstrue congressional intent on lender liability through foreclosure.

The second legal issue affecting lenders in secured lending transactions is EPA's construction and interpretation which essentially has done away with any protection for lenders, and suggests only that it is willing to settle in certain circumstances and within its discretion.

Listening to Mr. Johnson's testimony, I can think of no better situation in which EPA ought to exercise that discretion, but, nevertheless, he has spent $100,000 getting to the point where, at best, perhaps, he can propose it.

In June 1989, EPA issued a guidance document which we believe is an ironic title for the document since it provides very little guidance at all.

In addition to being based upon what would be, at best, questionable legal support, the guidance document only restates the statute in setting out the steps a lender must accomplish with regard to due diligence, and it is that same statute which has resulted in such conflicting and inconsistent court decisions.

Finally, the third issue facing lenders from legal matters regarding environmental liability, and I believe potentially most troublesome, is that even if EPA were to improve its interpretation of the defense, much of the litigation now involves private parties which bring suit against one another.

Private parties are not constrained by policy matters and do not have the interests of the Nation's small businesses at heart. Under the law, private parties can bring lawsuits against lenders using the same laws with the same confusion as can EPA.

Whatever position that private party is able to persuade some court ought to be the proper position, then that becomes a kind of legal patchwork that lenders must deal with when they undertake environmental due diligence in lending to small businesses.

I suggest that these three legal issues are addressed and satisfied by the legislation proposed by Mr. Chairman. First, the bill makes clear—which, by the way, the legislative history behind Superfund makes clear—that Congress did not intend to make secured lenders liable for cleanup costs by foreclosing on property. That would take care of the problem with the court's construction.

Chairman LaFalce. It is really difficult for me to enter into the mind of a judge who believes that Congress would have created a right, intending that right could not be exercised.

In order to say that we create an exemption for security interests, the exemption would only exist so long as it wasn't exercised, is almost illogical—well, almost—it is illogical.

Mr. O'Brien. I agree. When we tell our lender clients that, there is a surprised look, and they say, first of all, is this America? Then second, they say that's very cold comfort.

The second thing that I think the legislation would do would be to address the EPA's really useless guidance and eviscerating interpretation of that statute by making that controlling as opposed to EPA's position on these issues.

Then finally, with regard to the private parties problem, we think that private parties with this legislation in place would be unable to exploit the kind of vagueness and the inconsistency in the court decisions when bringing litigation as against lenders who have been involved in these transactions.

I have tried to set out the legal framework of these issues. The effect on the ability of small businesses to obtain financing is tremendous. In response to those risks, I think lenders are demanding what is now prohibitively expensive environmental due diligence, an industry which has been created out of the issues which we are addressing.

I support the passage of the legislation before the committee today.

Thank you.

[Mr. O'Brien's statement may be found in the appendix.]

Chairman LAFALCE. Thank you very much, Mr. O'Brien. Thank you very much, all panelists.

Mr. Lancaster.

Mr. LANCASTER. Thank you, Mr. Chairman. I don't see the green light and the red light, so I have a couple of questions that I think will take longer than 5 minutes, if I may proceed.

Chairman LAFALCE. Well, I think we will give you 5 minutes and then we will go to Mr. Hiler, Mr. Holloway, and then we will come back to you.

Mr. LANCASTER. All right, then I will ask all of my questions at once.

Chairman LAFALCE. They will have 5 minutes to respond.

Mr. LANCASTER. Mr. Schroeder and also Mr. Egerton, you may want to respond to this question.

I come from a rural background and recognize, as you do, the tremendous potential for environmental problems based on storage of pesticides, fertilizers, submerged tanks for the storage of diesel fuel, and that sort of thing.

Mr. Egerton, you mentioned a case where the parties actually required cleanup before they would go forward with the transaction. I wonder if EPA, at this point, or any court has, in fact, imposed liability on lenders in situations where there is the potential of agricultural contamination?

Mr. Bitner, you have discussed the problem of trustees being liable, recognizing that many banks, especially in my part of the country, are not just the holders of property in trust, but also manage that property in trust.

Is there to be a different standard for trustees who do, in fact, manage? If they become managers of the property, should their liability be different if they are simply holders of the property in trust?

Mr. Johnson, you did not discuss with us—and it may be that it was because of the standard expected of a bank 6 years ago—did you make any inquiry as to the potential environmental problems that might surround the property to which you took title as a part of this bailout through the Small Business Administration, or is this simply another example of situations where unwary bankers are now coming back to be haunted by decisions made under a standard of care that existed some time ago, but that might be different today?

Last, Mr. O'Brien, in your written statement, though you did not mention it in your oral presentation, you talk about the Fleet Factors case, and I believe, Mr. Clark, maybe you also mentioned that case which seems to say that lenders are the environmental police now and are going to have to control the environment as a part of their lending practices.

I wonder if either or both of you might want to comment further on that case and its impact.

Before I came to Congress, I was a member of a law firm that had a significant real estate practice, and I know that my former partners are very concerned that lawyers, themselves, may even have liability in the certification process for lending.

I wonder if you would comment on the question of liability of attorneys whose only role in the lending transaction is to certify title to the lender and to perhaps title insurance companies.

Mr. EGERTON. I think I was first. You asked specifically about the cleanup efforts on that particular fruit farm that we had——

Mr. LANCASTER. No, no; I am really not interested in anecdotes. I am interested in whether or not EPA has actually started holding lenders responsible? Are you aware of cases where EPA has held lenders responsible for agricultural contamination?

Mr. EGERTON. In this instance, I believe it was the State department of environmental conservation, as opposed to EPA, that directed the cleanup effort while we owned that property.

We did clean up. Purchasers who were coming in to buy that farm said, as a condition for my buying it, I want you to further indemnify me against any further claims up to an additional $200,000, but it wasn't at his initiative. It was at the department of environmental conservation.

Mr. SCHROEDER. I believe I was next. The EPA has not started any sort of process in our area. However, with the very deadly BF nerve gas that we can see from our town, environmental problems from that become the major topic in our area.

So, we know that a lot of people are going to be looking at things like that, and we have to become very aware of those things. It is just underground storage tanks and the chemicals you talk about on farms.

Mr. BITNER. I think I might be next. The reference was to banks that might be either holders or trustees in this case, and I would think that they both should be exempt, should be exempt in this case unless they have contributed to the pollution or the contamination.

That, of course, is one of the examples that I cited. Yes; there was a cleanup bill, and, in fact, the bank did manage that cleanup effort, but certainly that is one of the responsibilities when you undertake it, that this was a known fact when they accepted the charge.

Mr. LANCASTER. Well, of course, banks in my part of the country, oftentimes, for, let's say widows, will actually manage for many years the farming operation that was ongoing at the time of her husband's death.

Mr. **Bitner**. I see.

Mr. **Lancaster**. Those trustees will, in fact, manage those farms during which time there may be further environmental degradation. Should the banking institution who serves as trustee be responsible or is this liability something that should go to the widow who is actually the beneficiary of that trustee.

Mr. **Bitner**. I don't have an answer for that. I would have to be honest with you. We would have to do a little bit more thought about it, give a little more thought on that one because I don't know if the way it is being described to us, if the bank is managing it, they may well be contributing to it.

I mean, they have accepted that responsibility and whether there was contamination prior to that time, is it a shared responsibility? It could be answered several ways. I would say at this point we would try to come back to you with additional information on that.

Mr. **Johnson**. I believe I am next, Mr. Lancaster.

When we made the loan to Montana Pole, it was before the CERCLA law was passed in 1980.

In 1984, we set up to auction off the chattels, and the MDHES, which is the Montana Department of Health and Environmental Sciences, attempted to stop the auction because of suspected pollution, but the local district court ruled against them and allowed the auction to go on.

I believe that answers your question.

Mr. **O'Brien**. I believe the question was on Fleet Factors, Mr. Lancaster.

I agree, and, in my testimony, I say that it seems like lenders are now becoming environmental police. Particularly, one of the ways in which I think Fleet Factors is going to have a very serious impact on the kinds of loans that are typically made are working capital loans to small businesses, where the relationship is on a revolving basis and money is advanced as needed.

It appears now that lenders who are just financial people—they are not environmental consultants, and they are not somebody who operates the business of the borrower, but rather they step back, and they just look at numbers in books—are supposed to go out now and do due diligence before they actually advance additional funds or lend the money.

If they refuse to advance additional funds, the lender becomes liable, but if they advance additional funds anyway, they are still liable.

Chairman **LaFalce**. This is without regard to collateral.

Mr. **O'Brien**. Absolutely.

Mr. **Clark**. Just an additional comment on Fleet Factors. I agree with Mr. O'Brien's statement that the case law in this area is confusing at best and incomprehensible at worst.

I think Fleet Factors has taken that case law to its illogical extreme. Those of us who have had an opportunity to read this opinion find ourselves throwing it across the room or laughing during the course of that reading.

It is truly a problem, and I think it is something that this bill, under consideration here, can address directly.

Mr. **Lancaster**. Would either or both of you also comment on the liability of attorneys in the process?

Chairman LAFALCE. I think we are going to have to interrupt. We are going to have to get to that a little bit later because the 5 minutes has expired, and we will go now to the gentleman from Indiana who is a member of both the Small Business Committee and the Banking Committee.

Mr. HILER. I thank the chairman for yielding.

Mr. Chairman, I don't so much have any questions, I suppose, as I have just a brief comment.

First, all of your testimony was extremely enlightening, and I would have to say that it was very difficult to discern from any of your testimony some light at the end of the tunnel.

I mean, it appears that the situation is bad and is getting worse as opposed to getting better, and I think some of it gets to the difficulty that the chairman alluded to in his opening comments which was we can't write and change the law every day, every time some court in the land changes the interpretation of a statute.

The problem that we face is that today's society works something like this: Something's wrong, somebody must pay, and you happen to be in the area.

When that becomes the operational mode—the fact that something is wrong means somebody must pay, and we don't care exactly who it is just so long as it is somebody—structuring laws to get around that attitude is going to be extraordinarily difficult.

I think the chairman has a real gem of a bill. I suspect if we passed it today, 6 months from now we could convene another hearing, Mr. Chairman, and be looking at some new problems that developed from new interpretations of what we thought was very, very clear.

I guess I am concerned about some of the attitude that is developing in the country about the way we approach problems like these environmental problems. I can remember an amendment that came up when we were reauthorizing CERCLA and the amendment that was presented said that if someone who had disposed of waste in a landfill or in an area that was subsequently found to be contaminated, if that party could demonstrate that there was no material that they could have put into that landfill that contributed to the problem, and they were able to demonstrate that beyond a reasonable doubt, the amendment said that person should then be held innocent and should be removed from any liability to pay under joint and several liability laws.

That amendment was defeated on the floor of the House to a two to one vote, so part of the problem that we have is an attitude problem which is—there is a problem, somebody's got to pay, and you're in the area.

I think until we can find a way to get around that attitude problem, at best, our legislation is going to deal with yesterday's problem and may not be able to deal with tomorrow's interpretation.

Mr. Chairman, I commend you for your efforts, and, as I think some of the people on the panel probably know, Chairman LaFalce was the leader in the effort to repeal section 89, and, hopefully, he will be so successful with this bill.

I yield back, Mr. Chairman.

Chairman LAFALCE. It depends on Mr. Motley, Mr. Bitner, Mr. Clark, Mr. Schroeder, Mr. Johnson, Mr. Egerton, and Mr. O'Brien, and all those interested as to whether you are going to help me get that additional 100 to make 118 into 218. It goes a long way.

But, John, you made an excellent point. My bill, as good as it may be, doesn't deal with Fleet Factors, but we will take care of that down the pike, OK?

Mr. HOLLOWAY. Thank you, Mr. Chairman. I really don't have a particular question, but I would like to say thank you to you for H.R. 4494 and hope that we can move very rapidly with it.

Off of that though, I would like to ask these expert panelists here, do you foresee any problems—I know we have some attorneys as well as business people here—do you see any problems that are not covered under H.R. 4494 that could possibly arise?

Do you see anything right now on the horizon that would lead to more problems not covered under H.R. 4494?

Chairman LAFALCE. In no more than 5 minutes.

Mr. O'BRIEN. I might mention just one, and it is not necessarily a problem, but it is only that the environmental laws many times overlap, and the Resource Conservation and Recovery Act may have some sort of role to play in enforcing cleanups on secured lenders when they actually foreclose.

To that extent, that may sort of indirectly cause the same sort of liability that the CERCLA statute directly addresses.

Mr. CLARK. I think we could spend about the next 30 days in this room talking about the problems with CERCLA and the Superfund administration by EPA, but as far as the limited issue in front of us is concerned, the lender liability issue, I think the chairman's bill addresses it very adequately and does it quite well.

Chairman LAFALCE. I think Mr. Holloway does raise a good point though. We are dealing with a limited problem. It is a tremendous problem, but it is caused by particular judicial interpretations of particular limited sections of the law.

There are hundreds of thousands of other problems with CERCLA and all the environmental laws. I had some groups come in and say well, we sort of like what you're doing, but it doesn't take care of our problem, and so, we can't support your bill which takes care of that problem unless, at the same time, we take care of our problem.

When we start taking care of all our problems, it is going to take 5 years to pull it off. We don't have that time, and if we can identify one problem, and deal with one problem, let's do it. Then we will go to the next, the next, and the next.

If you say we have to do them all at one time, we might never get there, or we will have a lot of dead bodies along the way.

That's the problem I have.

Mr. Lancaster apparently had to leave, but he did raise a very good question and all his questions were outstanding, but, in fairness to the other members of the panel, I wanted them to get a chance before we exceeded his 5 minutes too much.

I think the last question he had, had to do with attorney liability situations. Mr. Clark and Mr. O'Brien, anything in particular, or would you care to deal with that issue?

Mr. CLARK. I'll take this one first I guess. My judgment is under the statute itself, there is no direct way an attorney is going to be held liable, but there are many indirect ways in which an attorney would be held liable in transactions of this type.

To give you an example, it is my firm's practice now, at my urging that every time we do any commercial, industrial, or sometimes even residential real estate transactions, we advise the client in writing that an environmental assessment should be done.

That's just a preliminary environmental assessment—$1,500 to $2,500—but it is my opinion that it would be malpractice for the lawyers in my firm not to make that recommendation.

Mr. O'BRIEN. The concern that I've had, Mr. Chairman, is typically what happens when, because the lenders know very little about environmental matters, they come with the reports to the attorney, and hand it over, and say, does everything look OK?

The attorneys don't know much more about it either, and so, we all talk about it a lot and, I guess, decide to go forward.

That's one area that I have some concern as to liability for attorneys.

Chairman LAFALCE. Sure. Attorneys very frequently at closings will give letters certifying good title. They are going to be very reluctant to issue such letters, or, if they don't issue such letters, they get title insurance. Of course, the problem is your title insurance has 50 exemptions. Is that going to be acceptable or not? This is a real hornet's nest.

Look, we have a tiger in our hand, but I think we also have a tiger by the tail here. Let's rein it in, and let's try to do it quickly.

I am not sure of the exact best legislative approach that is going to be used in this Congress, but we are going to try to find a legislative approach in this Congress. But before we spend too much time finding the legislative approach, gentlemen, let's get 219 cosponsors.

Mr. HOLLOWAY. Mr. Chairman.

Chairman LAFALCE. Yes.

Mr. HOLLOWAY. May I just say there is nothing more endangering to small business in this country than suits from all angles.

I think of a truck wreck that killed 12 people and, of course, didn't have enough liability insurance. Eventually, both the grain elevator and the farmer who grew the grain were involved.

Now there is no way in the world that those people can be held responsible in such a fashion. I think we have to pursue that. I don't think there is a greater problem in this country. I think we've got to address that, and I think it illustrates the burden facing small business in this country.

I, as a nurseryman, put trucks on the road, and this concerns me to a great extent. I don't know how to protect myself.

Chairman LAFALCE. Liability is very important, and sometimes I try to see these issues. I think we saw this issue early, in 1989.

We had the first hearings on the importance of the American/Canadian trade agreement. The first hearings in the 1970's on productivity, the first hearings on industrial policy, et cetera.

But way back in the 1970's I introduced two bills and had all sorts of hearings on them. People probably forgot about them.

One I called the Federal Uniform Product Liability law. I did this in 1977, and I also introduced a bill at that time, which I said was absolutely necessary, which I called the Federal Toxic Tort Act at that time.

We are going to have to revisit those concepts.

Thank you very much. The committee is adjourned.

[Whereupon, at 12:03 p.m., the hearing was adjourned, subject to the call of the Chair.]

APPENDIX

Statement of the Honorable Joseph M. McDade
Vice Chairman
Committee on Small Business
U.S. House of Representatives
June 7, 1990

Mr. Chairman, I appreciate your calling this hearing today to discuss H.R. 4494. I am proud to be a cosponsor of this legislation which would amend the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, or CERCLA, to limit the liability of lending institutions acquiring facilities through foreclosure or similar means.

This bill corrects a serious flaw in the CERCLA legislation. Under current law, a lending institution is liable for cleanup costs of an environmentally contaminated area on which it forecloses. This is true even though the lender in no way caused the contamination. The price of the cleanup is often greater than the value of the property.

The ramifications of this law are felt strongly in the small business community. Small firms, lacking sufficient funds of their own but required to clean up their property to remain in operation, must often borrow to pay the costs of cleanup. Lenders are unwilling to extend the needed funds because the additional debt may cause the business to close and the lender must then begin foreclosure proceedings. After foreclosing on the property the lender would be stuck with an environmentally contaminated property. H.R. 4494 designates that a lender, which has foreclosed on a property, is not an owner of operator of the business or property.

This is good legislation. I commend the Chairman for calling attention to this matter and taking the necessary steps to correct it. It is a further step in creating an environment in which small businesses are free to grow and prosper and contribute to our country's economic future.

STATEMENT OF CONGRESSMAN IKE SKELTON

HEARING ON LENDER LIABILITY UNDER SUPERFUND

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

JUNE 7, 1990

MR. CHAIRMAN:

I WANT TO JOIN MY COLLEAGUES IN ACKNOWLEDGING THAT THESE HEARINGS AND THIS ISSUE OF THE LIABILITY THAT A LENDER IS EXPOSED TO UNDER THE SUPERFUND PROVISIONS (CERCLA) ARE VERY IMPORTANT NOT ONLY TO OUR COUNTRY'S FINANCIAL STRUCTURE BUT ALSO TO THE SMALL BUSINESS MEN AND WOMEN WHO NEED TO FIND FINANCIAL SUPPORT TO START OR EXPAND THEIR OWN BUSINESSES.

THE UNFORSEEN THREAT OF SUPERFUND LIABILITY POSES A SIGNIFICANT THREAT TO THE RURAL COMMUNITY WITH WHICH I AM MOST FAMILIAR. FARMERS AND SMALL TOWN BUSINESSES ARE ALREADY HARD-PRESSED TO FIND NEW SOURCES OF CAPITOL TO START OR EXPAND THEIR BUSINESSES. EXISTING BANKS, SAVINGS AND LOANS AND THE FARM CREDIT

INSTITUTIONS (WHO I AM PLEASED TO SAY WE WILL HEAR FROM IN THIS HEARING) ALREADY FACE DIFFICULT BUSINESS JUDGEMENT DUE TO THE INHERENT RISKINESS OF THE FARM AND RURAL ECONOMIES. THE THOUGHT THAT THEY WOULD NOW HAVE TO ESTABLISH A SUBSTRUCTURE TO MONITOR ENVIRONMENTAL COMPLIANCE AND MAY STILL BE HELD LIABLE FOR THE INADVERTENT CARELESSNESS OF AN EMPLOYEE OVER WHOM THEY EXCERCISED NO CONTROL OR FOR AN UNDISCOVERED ACCIDENT THAT OCCURRED YEARS AGO COULD THROW A CHILL INTO RURAL LENDING THAT WOULD DO SERIOUS DAMAGE TO THOSE ECONOMIES. UNLESS WE ESTABLISH A CLEAR SEPARATION FOR THE PURPOSES OF CERCLA BETWEEN THE BUSINESS OF LENDING MONEY AND THE BUSINESS OF OPERATING OR PARTICIPATING IN A BUSINESS, WE SIMPLY HAVE A SYSTEM THAT IS DESTINED TO FAIL.

Let me also make it clear that I am not advocating a liability exemption for a business owner, absentee owner or other equity participant in these businesses. I draw the line here because those owners would stand to benefit in the short term at the expense of our long term concern for the environment unless they remain responsible for toxic carelessness. The lender does not stand to enrich itself in the short term by neglecting or scrimping on waste management protections as an investor or an owner might; the lender simply collects its interest. Yet the lender, be it a bank, a savings and loan, a government agency or a government sponsored enterprise, is the easy target; the available, immovable pillar of the community that gets left holding the bag.

LENDERS WILL WALK AWAY FROM LOANS TO FARMS, FARM SUPPLY RETAILERS AND WHOLESALERS, FARM GOODS MANUFACTURERS, PETROLEUM SUPPLIERS AND JOBBERS WHERE THEIR RISK OF FUTURE EXPOSURE AS THE ONE ASCERTAINABLE 'DEEP POCKET' OUTWEIGHS ANY RETURN ON INVESTMENT THAT THEY COULD EVER HOPE TO RECEIVE. IT IS PRECISELY THESE LENDERS THAT KEEP RURAL AMERICA ALIVE. THERE ARE NO VENTURE CAPITALISTS, ARBITRAGERS, CORPORATE RAIDERS, BOTTOM FISHERS OR FAST-BUCK TURN-AROUND SPECIALISTS WAITING IN THE WINGS TO FINANCE FARM RELATED BUSINESSES IN RURAL AMERICA IF THE CONVENTIONAL LENDERS TURN THEIR BACKS.....RURAL BUSINESSES REQUIRES REAL WORK. WITHOUT THE CAPITOL TO FEED THESE BUSINESSES AND HELP THEM GROW, RURAL AMERICA AND SMALL TOWN AMERICA WILL GRIND TO A HALT.

THE ONLY SERIOUS ARGUMENT FOR EXTENDING THE SUPERFUND PROVISIONS TO LENDERS IS THAT THIS WOULD APPLY STRONG PRESSURE ON THOSE WHO SEEK TO BORROW MONEY TO INSTITUTE ENVIRONMENTALLY SOUND BUSINESS PRACTICES. IN THEORY, THE LENDER WOULD WITHHOLD MONEY UNTIL IT WAS ABSOLUTELY CERTAIN THAT; NO PRE-EXISTING PROBLEM IS CONNECTED TO ANY OF THE PROPERTY OWNED BY THE APPLICANT; THE APPLICANTS' BUSINESS PROCEDURES ENCOMPASSED ENVIRONMENTAL SECURITY; THE APPLICANT WAS ABLE TO SECURE SUFFICIENT BONDING OR INSURANCE TO INSULATE THE LENDER. HOWEVER, THERE ARE A GREAT MANY QUESTIONS LEFT UNANSWERED BY SUCH A POLICY. INSURANCE INDUSTRIES WERE SUPPOSED TO PROVIDE THE SAME FUNCTION, YET THEY HAVE PROVED WOEFULLY INADEQUATE AS 'ENVIRONMENTAL POLICE' PREFERRING INSTEAD TO USE THEIR

RESOURCES TO FIGHT POTENTIAL CLAIMS. SECOND, HOW DO WE AVOID THE PROBLEM OF ENVIRONMENTAL BLACKMAIL ("IF YOU FORECLOSE, I WILL DUMP DANGEROUS CHEMICALS ON THE PROPERTY, WHICH YOU THE LENDER WILL BE FORCED TO SPEND MILLIONS OF DOLLARS TO CLEAN UP.") ALSO, HOW DO WE AVOID MAKING THE LENDER THE EASY TARGET THE PROSECUTOR KNOWS WHERE TO FIND THE LENDER, KNOWS HOW TO SERVE HIM AND KNOWS HOW TO GET ITS ASSETS. THERE IS NO INCENTIVE TO GO AFTER THE POLLUTERS.

I AM CONVINCED THAT THE LENDERS WOULD SIMPLY WITHDRAW SUBSTANTIALLY FROM THE MARKET RATHER THAN PLAY THIS GAME OF ENVIRONMENTAL ROULETTE. THE CURRENT POLICY IS BAD POLICY AND I APPLAUD THESE HEARING AND ENCOURAGE THE DEBATE ON LENDER LIABILITY.

FOR THIS REASON, MR. CHAIRMAN, I WOULD SIMPLY SAY THAT I SUPPORT YOUR BILL AND THE OTHER BILL INTRODUCED BY MR. CONTE, AND I FEEL THAT THESE HEARING WILL PUT INTO PERSPECTIVE THE MAGNITUDE OF THE PROBLEM FOR SMALL BUSINESSES.

STATEMENT

OF

LEE A. SCHROEDER

PRESIDENT

OF

THE FIRST NATIONAL BANK

DANA, INDIANA

ON

ENVIRONMENTAL LIABILITY

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

SMALL BUSINESS COMMITTEE

JUNE 7, 1990

Mr. Chairman and members of the Committee, I am Lee A. Schroeder, President of the First National Bank in Dana, Indiana. I welcome the opportunity to offer my views on the critical issue of environmental liability and its effect on community banks such as the one I run in Dana.

The First National Bank of Dana is located on the Western Border in the central part of Indiana. It is a town of about eight hundred (800) people in a rural area with a county population of approximately nineteen thousand (19,000). Our bank is the only financial institution serving Dana and the surrounding communities. The total assets of the bank are a little over thirteen and a half million and we have in capital $1,550,000 and in loan reserves somewhat over $70,000.

Our bank, in the last four years has invested in new computer equipment and software and also in remodeling our building by doubling the floor space so as to better serve our customers. We have been able to maintain satisfactory earnings to keep our capital within the Comptroller of the Currency's requirements. By continuing to show a profit, we help assure our customers that we will be here for many years to serve the needs of the population. We have also invested heavily into our community by loans secured by real estate, residential properties and small business establishments. Some of our loans are also secured by farm property. We presently loan up to 66.8% of our loans to deposits and 52% of those loans are secured by some form of real estate. Twenty-four percent (24%) of our loans are made up of commercial loans. As of the end of 1989, this bank had $820,000 in loans secured by farm land, $2,931,000 secured by loans for 1-4 family residential property, $776,000 in loans to farms and $1,150,000 in loans to small businesses in our community.

With the recent surge of court decisions on environmental liability, our bank has had to carefully consider what types of businesses in Dana could present liability problems. Some of the businesses that are located in Dana that could be affected by possible environmental problems are the community's only auto body shop and convenience store which is also the only place where you can buy gas in Dana. (The other service station closed because of environmental problems and cannot be reopened because it cannot get financing.) Mr. Chairman, there are only two auto repair places in the community and our bank does business with both. There is also only one fuel dealer in the community and we have loaned on the property where the bulk storage is done: financed and secured by that property. There are two fertilizer plants in the community and our bank has property mortgaged that is close to those plants. In addition, we have financed farm land and I have no proof now that there has never been any kind of accidental spillage of chemicals on any of those farms.

As an example of how real estate value can deteriorate very quickly, a couple, who has had loans with us before including another residential property secured by real estate, requested that we make a first mortgage loan on property they were going to purchase. After examining the property, and noting that it was adjacent to a liquid fertilizer plant where chemicals have been stored, we had no choice but to deny making the loan because of possible environmental problems. I found out approximately one week later that another bank also turned this loan down for exactly the same reason and they had not discussed the situation with this bank and had no way of knowing that we had turned the loan down because of possible environmental problems.

There are several things that worry us here at this bank. Most of the businesses and farms that we have financed occurred some time ago before this problem became apparent. I am not so sure how we would have reacted had we known that possible environmental liability could be facing our bank. As the only bank in the community, we are facing a doubled edged sword: if we do not finance these businesses (they are all family-owned) then these people will have to close down because they cannot get financing. Their properties, which did have a fair amount of value, could become worthless to them and anyone else. This would hurt the economy of our entire community and the surrounding area because these businesses are very much needed.

On the other side of the coin, if we continue to finance these businesses and farms, we might face an extremely costly environmental clean-up because we had to foreclose on one of these businesses or otherwise face liability by exercising "too much control." If this happens, we could end up violating the duty we owe both to our shareholders and the bank's depositors. This community could be jeopardized because our $1.5 million in capital could be wiped out very quickly.

The bank's relationship with the community is more than just commercial lending. We are a part of this community and I feel we do a good job of serving our community. For example, our bank makes fifty dollar ($50) loans to those people who need to buy groceries or pay a utility bill until their social security check arrives. We do not charge service fees to community organizations even though they may have only a few dollars in their checking account. We allow groups or organizations to use some of our facilities such as a meeting room or to use our copier to make programs or notices without charge. We also make our staff available for other voluntary organizations and, therefore, we feel that if we were forced to close because of an environmental problem that we did nothing to help create, it would be disastrous to our community.

I know that there are hundreds and hundreds of banks like ours across this nation that face this problem: trying to keep their communities from losing small businesses. If, however, banks are unable to finance those businesses because of unforeseen environmental problems, then not only will small businesses fail, but so eventually will the banks. It will not be long before the towns themselves will deteriorate and cause an ever-growing economic problem for this country.

Our bank had begun to evaluate its loans for environmental problems. We have not yet finished the project, and I am not sure what our final decision will be on our loans that may have potential environmental problems that are more than we currently believe to be the case. We do not turn our backs on our neighbors and I don't think that is what we want to do in the future; however, this result could be forced upon us because of the possible environmental problems that we might face. Our loans have historically been very sound and we do not foresee any foreclosures in the near future; however, I am not so sure that we can rely on that philosophy with ambiguous laws and with examiners taking into account the collateral of our loans. I have personal knowledge of the farmers and the small business owners of this community and I know that they are all environmentally conscious of what the rules and regulations are and none of them would purposely pollute our land. No matter how careful someone is, there is always the possibility of environmental damage to farm land. As you know, Mr. Chairman, in past decades it was not uncommon to have dumps in rural areas because of the lack of public landfills. Many of those dumps have been covered over by several feet of good topsoil which is now being farmed. While nothing toxic may have been placed in those dumps, there is no way to tell where these dumps are located or whether they contain toxic wastes. I know that environmental tests can be done to see if there are any environmental problems on real estate, however, the cost of checking farm acreage is prohibitive for the farmer.

We have residential property selling from twenty to forty-five thousand dollars in our community and I doubt if any of those people could afford an additional two thousand dollars, or more, to have their property tested for environmental purposes before closing. Most importantly, I don't think we have anyone in the area that is qualified to do the testing. There may be someone in Indianapolis which is seventy-five miles away. The cost of someone from an Indianapolis firm to come travel to Dana, Indiana to test would also probably be extremely prohibitive.

In conclusion, Mr. Chairman, I spoke with an officer of a rather large corporation a few days ago about this very problem and the fact that I had been asked to testify before this Committee. He asked me, "Playing the devils advocate, why should we as citizens be concerned about banks and their problems?" When I explained to him that it was not a matter of saving banks and their shareholders but saving the small businesses and the communities whether large or small and allowing banks to continue to finance those small businesses, he realized how important this matter was to everyone.

A great percentage of banks are themselves small businesses owned by local shareholders. These shareholders can ill afford to lose the investments that they have made in community banks across our nation. If these banks continue to be exposed unfairly to environmental liability, they will be forced out of business. Without local banks, who can they turn to?

I would be happy to answer any questions.

NFIB
National Federation of
Independent Business

STATEMENT OF

John J. Motley III
Vice President
Federal Governmental Relations

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before:	House Small Business Committee
Subject:	Superfund Lender Liability
Date:	June 7, 1990

Mr. Chairman, on behalf of the National Federation of Independent Business (NFIB), I want to thank you for the opportunity to testify on this important issue to small business. We support your efforts to pass H.R. 4484 and restore Congress' original intent with regard to innocent lender liability under Superfund.

Before I specifically address the problems facing small business with respect to Superfund Lender Liability, let me tell you about NFIB's membership. The average number employees hired by our members is 13. The average gross sales for an NFIB member is around $350,000 annually. Moreover, the average NFIB member often has personal relationship with his or her bank and employees. The capitalization of the business is often the owner's own money or collateralized by the owner's home. Without banks to provide operating capital, most small businesses would not exist financially.

NFIB is the nation's largest small business advocacy organization, representing the interests of more than 500,000 small

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The Guardian of
Small Business

and independent business owners throughout the country. Our mission is to give small and independent business owners a voice in governmental decisionmaking.

The membership of NFIB closely parallels the national business population. That is, we have about the same percentage of members in the construction industry, the manufacturing industry, and retail industry as exists in the national business profile.

These small business owners could be adversely affected by the lending situation which exists today if the Chairman's bill is not enacted. Currently, lenders are becoming increasingly reluctant to make loans to businesses for fear that they may incur Superfund liability into the hundreds of thousands of dollars.

H.R. 4494, introduced by the Chairman, restores to the Superfund law its original intent. This bill would statutorily direct courts to interpret the Superfund law according to its original intent.

Specifically, H.R. 4494 clarifies that lenders, trustees, fiduciaries, government agencies and others who hold title through foreclosure or operation of a trust agreement are not liable. Current law already places the burden of liability for toxic releases or threats of releases on the responsible owners and operators of facilities, not on innocent lenders.

Language in current law, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), made clear the intent of Congress that innocent secured parties not be held liable. The law provides that, in narrowly drawn circumstances, parties who have an interest in land in order to protect a contractual security interest are not "owners or operators" under law.

Unfortunately, the courts have eroded this exemption. Rulings, such as U.S. vs. Maryland Trust (1986) and Guidice vs. BFG Electroplating (1989), have held that lenders attempting to protect a security interest, most typically through foreclosure, may be held liable as owner/operators. This is true even when they hold property for a short time and it can be scientifically proven that contamination did not occur during that brief period.

Further, these court decisions have created uncertainty about the role of innocent trustees and other fiduciaries who take property under a trust or contractual arrangement. For example, pension funds which inadvertently invested in contaminated properties could be threatened has been exposed to Superfund liablity.

These court decisions essentially have undercut the law, creating problems for consumers, small businesses, farmers, homebuilders, and lenders. In fact, many banks are now unwilling to make loans without extensive and costly land testing by the landowner or purchaser.

Because the intent of the Superfund law is to assure that contaminated land is cleaned up, those actively involved with the ownership and the use of land were intended to be liable for its restoration. Any other interpretation is unfair and unnecessarily threatens the availability of loans to small businesses.

Ultimately, the results have been higher costs for borrowers, refusals to lend to certain businesses, and uncertainty in the marketplace.

In a 1980 NFIB Foundation Study entitled Small Business and Banks, availability of credit was their third top concern. Further, there are clear indications from Mandate Votes Special 8 and 455 that small business owners want banks to operate within banking parameters. Votes taken by NFIB on their Mandate Ballots 449, 480, and Special 18 indicate that they want the polluter to pay. Further, they are willing to do their share to assure a clean environment.

Therefore, NFIB members support language as contained within the legislation which assures credit availability by not imposing excessive and undue risks on banks.

The crux of the issue is the ability of all small business owners to obtain loans for operating expenses and for the growth of their firms. Without passage of the LaFalce legislation, many small business owners will likely be threatened financially.

Although the language of the LaFalce bill specifically addresses lender liability, there is a direct connection between banks and small business. Not to overstate the obvious, but small businesses unable to obtain loans are usually unable to grow. It is really that simple.

Potentially vulnerable to lender reluctance to loan money are gas station owners, autobody shops, and garages. Other firms which use chemicals like printers, drycleaners, carpet cleaners, pest control firms, or agri-business operations may also be at risk. Then, we come full circle. Later sale of their land by these business owners listed above may be stifled by reluctant banks not willing to lend to later purchasers.

We have heard from members in areas as diverse as New Hampshire, Florida, and Idaho. They tell us about the problems they face in land contamination, soil testing, and loan availability.

In conclusion, I would like to thank Chairman LaFalce and the Members of this Committee for addressing this concern of small business. On behalf of NFIB members across the nation, I pledge our support for passage of this needed legislation.

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485 LEXINGTON AVENUE
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STATEMENT

OF

WILLIAM L. BITNER III

CHAIRMAN & PRESIDENT

THE FIRST NATIONAL BANK OF GLENS FALLS

GLENS FALLS, NEW YORK

PRESIDENT

NEW YORK STATE BANKERS ASSOCIATION

ON

SUPERFUND LENDER AND FIDUCIARY LIABILITY

BEFORE THE

HOUSE COMMITTEE ON SMALL BUSINESS

OF THE UNITED STATES HOUSE OF REPRESENTATIVES

JUNE 7, 1990

Good morning. Mr. Chairman and Members of the Committee, I am William L. Bitner III. I am pleased to testify this morning as the Chairman & President of The First National Bank of Glens Falls, Glens Falls, New York, a community bank located in upstate New York. I am also pleased to testify as the President of the New York State Bankers Association, which is the trade association representing New York State's commercial banking industry. Our membership consists of independent community, regional and money center banks.

Mr. Chairman, the issue of environmental liability under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), or more commonly known as "Superfund", is critically important to New York bankers in our capacities as lenders and as corporate fiduciaries. We appreciate and support your efforts to provide reasonable relief for banks and bankers from the potentially unlimited liability and operating difficulties we are experiencing in the wake of the Superfund legislation and court decisions that have interpreted the law. We strongly support your bill, H.R. 4494. We also note that many other trade associations, including the American Bankers Association, have also identified this issue as a top priority. We believe H.R. 4494 more realistically reflects the intent of the Superfund law and its 1986 amendments, as they relate to a bank's liability for environmental cleanup when the bank did not contribute to the contamination.

Today, I would like to briefly share with the Committee examples of the hardships that the federal Superfund law and the related New York State environmental laws have created for my bank and others throughout New York State. I will provide examples where banks have served as both commercial lenders and as corporate fiduciaries.

The first example is one that my bank, **The First National Bank of Glens Falls** has experienced.

In 1982 and 1983, one of our customers, a small northeastern New York reclamation center, suffered business setbacks that resulted in judgments and liens being filed against the proprietors.

Our bank worked diligently with the borrower to reorganize its debt and entered into several consolidation and extension plans, none of which seemed to solve the problems of the borrower. In 1986 and 1987, restraining notices from the creditors were being delivered to the bank and subsequently followed by executions against the borrower's accounts. The bank was precluded from lending more money because the collateral was real estate that the borrower had used to store reclaimed large utility transformers. The transformers were suspected as having contained a large amount of oil that may have contained P.C.B.'s, a known carcinogenic substance. The bank's business decision was mandated by the Superfund law that unfairly punishes an owner of real estate, regardless of the fact that the bank had no knowledge of or participation in the pollution of the real estate. This law has caused banks, nationally, to consider many small business loans that even hint of Superfund characteristics as being undesirable.

In late 1986, the proprietorship filed under Chapter 11 of the federal bankruptcy law.

I would like to cite some additional examples in which the Superfund law has adversely affected New York **commercial banks** throughout the State.

Several years ago, **The First National Bank of Long Island** extended a $1 million loan to a real estate holding company located in Nassau County, New York. The loan is collateralized by a first mortgage on a forty-two thousand square foot factory building, and has about twelve years until it is paid in full. During December 1989, the bank received a letter from the president of this company stating he was moving his manufacturing firm and its key employees to Atlanta, Georgia. In this letter, the president requested the bank to waive its loan prepayment penalty and place the loan on an interest only basis until the property was sold or rented.

About one year ago, the bank learned that the New York State Department of Environmental Conservation ("DEC") had classified the industrial park where its borrower is located as an inactive hazardous waste site due to significant ground water contamination. The park, which is located in Nassau County, New York, contains about one hundred businesses. The DEC designated the area as a significant threat to public health. Confronted with what the bank perceived as a problem in selling this property, the bank then addressed a letter to its borrower indicating that the bank would waive the prepayment penalty should the building be sold by May 15, 1990. This date has passed and the building has not been sold or rented. The borrower will be moving by July 1, 1990 to a brand new facility in Georgia where it has taken on a new loan. This puts this New York community bank in jeopardy, should the borrower be unable to make its loan payments. At this time, the bank probably would not take title to the property under a foreclosure action, even though the borrower was not responsible for polluting the ground water. If the "Superfund Law" were amended to limit or eliminate the liability of clean-up, and if the bank were to foreclose, the bank could take title.

During the latter part of the 1970's, the **State Bank of Chittenango** held a mortgage on real estate containing a residence and another building where compounds used in the dye industry were produced and processed. The original loan was approximately $50,000 and the borrower was a chemical company located close to Chittenango, New York.

Due to a series of unfortunate events, the once solid company failed, and the bank charged off approximately $16,000 in December, 1980. Three years later, the bank acquired the property from Onondaga County for the amount of taxes owing in the amount of $12,002. However, the Onondaga County Legislature took the unusual step of passing a special resolution under which the bank was given a quit claim deed instead of a tax deed. At the time, the bank was not informed that the site had already been placed on the county's superfund list.

To date, the bank has been forced to spend nearly $80,000 in consulting fees, legal fees, testing costs and clean-up charges. In addition, another bank with whom the State Bank of Chittenango has a definitive merger agreement, has spent an amount reported to be nearing $100,000 for testing at the site. The State Bank of Chittenango has accrued nearly a quarter of a million dollars more for possible further remediation.

Numerous samples of soil and water taken from the site and adjoining properties have been tested for suspected hazardous wastes, and all have proved negative. Nonetheless, the site still remains listed. Moreover, the **merger proposal has been stalled for more than a year** because of concerns about the final cost.

Needless to say, the bank has grown very cautious about making loans to any business where chemicals or any other hazardous waste might be found. This caution would include gasoline stations and manufacturing plants, and may very well be extended to farm loan applications, plant nurseries, etc.

In 1986, **Marine Midland Bank** was asked to be the lead bank in a leveraged buyout of XYZ Corp., a local industrial solvents manufacturer and metal processor, located in western New York. The financing was set at $50 million. However due to CERCLA considerations, an environmental audit was deemed necessary at a cost of $250,000. The borrower/buyer refused to pay for the environmental audit. Marine Midland Bank lost the opportunity to finance the LBO when another bank agreed to pay for the environmental audit.

Marine Midland Bank planned to syndicate 50% of the loan. Therefore, Marine Midland lost interest payments on the first $25 million; lost a 3% interest spread on the second $25 million; and all fees and deposits associated with the loan as well as ongoing corporate services for the newly established company.

For corporate executors and trustees, the problems under the Superfund law are also substantial and present difficult business and operational challenges. For example, there are at least three major areas of concern. (1) **Delay** in a bank's acceptance of a trust or estate until the bank has determined that it will not incur unnecessary liability and costs for environmental clean-up of property contained in the trust or estate. (2) **Bank liability** for clean-up costs. (3) **Bank liability** to trust and estate beneficiaries who may claim that a bank improperly used trust or estate assets to conduct an environmental audit or to clean-up an environmental hazard existing on a trust or estate real estate asset.

I would also like to cite two specific examples in which the federal Superfund law has adversely affected New York commercial banks serving as **corporate executors and trustees.**

A Bank in western New York State recently accepted an appointment as an executor and testamentary trustee for a machine shop owner in Lockport, New York. The bank accepted its appointment and has spent approximately $125,000 from the estate to clean up oil from the loading dock area of the plant. Because the estate exceeds $1 million, the bank made a business judgement that its liability for cleanup is reasonably covered.

However, there was extensive delay that was caused at the time of the bank's acceptance of its appointment, as the bank had to make sure its assets were not going to be required to clean the loading dock. This caused chaos in the business after the owner's death which could have been avoided.

The **Manufacturers Hanover Trust Company** acted as executor on an estate that held a valuable commercial property located on Long Island, that was originally valued at $2,500,000. In the process of selling the property, tests indicated that acetates used in producing ladies lingerie were dumped on the property. Cleanup expenses including environmental legal fees, engineering, carting, excavation, etc., cost over $1 million which could have been charged against the bank individually as the executor, if the assets of the estate were insufficient to cover such costs.

In conclusion, these examples point out the first-hand legal and operational problems that commercial banks are experiencing in complying with the federal Superfund law. We feel that these results were not intended by the Congress when a bank forecloses on collateral to protect its security interest on a loan or serves as a corporate executor or trustee-and in those capacities, does not contribute to environmental contamination.

We will continue to strongly support your efforts to provide relief to banks from the onerous and inequitable burden we continue to experience under the Superfund law. We appreciate all your efforts in urging your colleagues to pass H. R. 4494 which you have sponsored and we hope that the Energy and Commerce Committee will hold hearings on this important issue during this legislative session.

The New York State Bankers Association has previously provided you a draft of legislation which merges some of the concepts we discussed with you during a recent meeting. Our draft takes into consideration issues raised during our discussions and some of the provisions contained in Senator Garn's related bill, S. 2319. We urge you to consider our proposal as well, during the Committee's consideration of this important issue and we request that a copy of our proposal be inserted into the record. We look forward to working with you and our New York Congressional delegation on this critical issue.

Thank you.

SECTION 1. AMENDMENT TO THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980

(a) AMENDMENT TO DEFINITION OF OWNER OR OPERATOR.--

(1) EXCLUSION.--Section 101(20) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601(20)) is amended by inserting after subparagraph (D) the following new subparagraphs:

"(E) In the case of any facility, the term "owner or operator" does not include a designated lender if (i) such designated lender acquires ownership or control of such facility by virtue of realizing upon a security interest in (I) such facility or (II) an ownership interest in any person owning or operating such facility and (ii) such security interest secured, in whole or in part, indebtedness previously contracted. The exclusion provided under this subparagraph shall not apply in the case of such facility (i) if such designated lender has caused or contributed to or causes or contributes to the release or threatened release into the environment of a hazardous substance from such facility or (ii) to the extent of any actual benefit that has been or is conferred on such designated lender by removal, remedial, or other responsive action with respect to such facility.

"(F) In the case of any facility, the term "owner or operator" does not include a designated fiduciary, or an indenture trustee (as defined in section 303(10) of the

Trust Indenture Trust Act of 1939), which acquires directly or indirectly any legal or beneficial interest in, or possession, management or control of, any facility by virtue of his, her or its being appointed or designated, or acting as, such a designated fiduciary or such an indenture trustee. The exclusion provided under this subparagraph shall not apply in the case of such facility (i) if such designated trustee or indenture trustee has caused or contributed to or causes or contributes to the release or threatened release into the environment of a hazardous substance from such facility or (ii) to the extent of any actual benefit that has been or is conferred on such designated trustee or indenture trustee by removal, remedial, or other responsive action with respect to such facility.

"(G) In the case of any facility, the term 'owner or operator' does not include the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System, the National Credit Union Administration Board, any Federal reserve bank, or any Federal Home Loan Bank, if such entity acquires ownership or control of such facility in connection with (i) the exercise of receivership or conservatorship authority or (ii) the provision of any loan, discount, advance, or other financial assistance. The exclusion provided under this subparagraph shall not apply in the case of such facility if such entity has caused or contributed to or causes or contributes to the release or threatened release into the environment of a hazardous substance from such facility."

(2) DEFINITION OF DESIGNATED LENDER.--Section 101 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601) is amended by adding at the end of the following new paragraph:

"(39) DESIGNATED LENDER.--The term 'designated lender' means--

"(A) any depository institution (as defined in section 3(c)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(1)));

"(B) any person that controls, is controlled by, or is is under common control with any depository institution (as defined in section 3(c)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)(1))) that, in lieu of such depository institution, realizes upon a security interest of such depository institution in any property;

"(C) any insured credit union (as defined in section 101(7) of the Federal Credit Union Act (12 U.S.C. 1752(7)));

"(D) any unit of the Farm Credit System referred to in section 1.2(a) of the Farm Credit Act of 1971 (12 U.S.C. 2002(a));

"(E) any agency, department, or other unit of the United States Government or of any State or local government engaged in making, acquiring participation interests in, or guaranteeing loans secured, in whole or in part, by facilities; and

"(F) any person who has made or makes, has acquired or acquires a participation interest in, or has guaranteed or guarantees a bona fide loan secured, in whole or in part, by a perfected security interest in (I) a facility or (II) an ownership interest in any person owing or operating a facility, but, in the case of a loan made or guaranteed, or in which a participation interest is acquired, by such person after _____________, 19___, only if, before making or guaranteeing, or acquiring a participation interest in, such loan, such person followed adequate procedures to determine the absence of hazardous substances in, on, or under such facility and no such hazardous substance was determined to exist."

(3) DEFINITION OF REALIZING UPON SECURITY INTEREST.--Section 101 of the Comprehensive Evironmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601) is amended by adding at the end the following new paragraph:

"(40) REALIZING UPON SECURITY INTEREST.-- The term 'realizing upon a security interest' in any property means acquiring title to such property through (A) any purchase of such property at a sale conducted by a public official, secured creditor, trustee or other person to satisfy, in whole or in part, indebtedness secured by such security interest, (B) in lieu of any such sale, any conveyance, transfer or retention of such property to satisfy, in whole or in part, such indebtedness or (C) in the case of any agency, department, or other unit of the United States Government or of any State or local government, any conveyance or transfer of such property from a secured creditor that held such security interest to secure indebtedness in which such agency, department, or other unit held a participation interest or that such agency, department, or other unit guaranteed, in whole or in part, if such conveyance or transfer extinguishes, in whole or in part, such participation interest or guarantee."

(4) DEFINITION OF DESIGNATED FIDUCIARY.--Section 101 of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C 9601) is amended by adding at the end the following new paragraph:

"(41) DESIGNATED FIDUCIARY.--The term 'designated fiduciary' means any person serving or acting, whether by judicial appointment, by operation of law or otherwise, in any capacity as any kind of administrator, executor, personal representative, guardian, inter vivos or testamentary trustee, donee of a power during minority, public administrator, committee of an incompetent, conservator, curator, custodian, or in any other kind of personal fiduciary capacity for the benefit of another."

(b) EFFECTIVE DATE.--The amendments made by subsection (a) shall take effect on the date of the enactment of this Act.

SECTION 2. AMENDMENT TO THE FEDERAL DEPOSIT INSURANCE ACT.

(a) AMENDMENT REGARDING AGENCY ACTION.--The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by inserting after section 32 the following new section:

"SEC. 33. EVALUATION OF ENVIRONMENTAL RISKS.

Each appropriate Federal banking agency shall take necessary actions to assure that depository institutions develop and implement adequate procedures to evaluate potential environmental risks that may arise from lending and fiduciary activities. In taking such actions, such Federal banking agency shall consider and act to ameliorate the transactional costs that such procedures may impose on consumers, small farms and small businesses borrowing from such depository institutions."

(b) EFFECTIVE DATE.--The amendments made by subsection (a) shall take effect on the date of the enactment of this Act.

SECTION 3. AMENDMENT TO THE FEDERAL CREDIT UNION ACT.

(a) AMENDMENT REGARDING AGENCY ACTION.--The Federal Credit Union Act (12 U.S.C. 1781 et seq.) is amended by inserting after section 212 the following new section:

"SEC. 213. EVALUATION OF ENVIRONMENTAL RISKS.

The Board shall take necessary actions to assure that depository institutions develop and implement adequate procedures to evaluate potential environmental risks that may arise from lending and fiduciary activities. In taking such actions, the Board shall consider and act to ameliorate the transactional costs that such procedures may impose on consumers, small farms and small businesses borrowing from such depository institutions."

(b) EFFECTIVE DATE.--The amendments made by subsection (a) shall take effect on the date of the enactment of this Act.

Statement of Associated Builders and Contractors

by

ROBERT CLARK, ATTORNEY

LOWE GRAY STEELE & HOFFMAN
INDIANAPOLIS, INDIANA

before the

SMALL BUSINESS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

JUNE 7, 1990

Speaking for the Merit Shop

729 15th Street, N.W.
Washington, D.C. 20005
(202) 637-8800

Mr. Chairman and Members of the Committee:

My name is Robert Clark. I practice environmental law in Indianapolis with the law firm of Lowe Gray Steele & Hoffman. As head of the environmental law section, I am here today to discuss my concerns not just for the financial community but for a segment of the small business community which depends greatly on reasonable access to capital financing--the small businessmen and women who are builders and contractors.

My firm is a member of and represents the Associated Builders and Contractors in Indiana. Contractors are second tier players in this problem but are clearly affected nonetheless. When environmental problems arise with regard to a commercial site and the financing falls apart, can't be obtained or is rescinded, more than the lender, buyer and seller are affected. Often the contractor who has agreed to build the project for the buyer or developer also loses. And, unfortunately, it is often the contractor who loses the most.

Although reasons of privilege keep me from discussing fact-specific cases, I can relate to you some scenarios which will illustrate the dimensions of this problem as it relates to contractors.

Let's assume that a developer wishes to purchase a piece of property for development as a small industrial park or retail strip center. The developer will sign a purchase agreement with the seller and will obtain a financing commitment from a lending institution to finance the construction of the project. The permanent financing on the construction has not yet closed; among other things the permanent financing is conditioned on the receipt of and a favorable environmental assessment. In the meantime, the developer contracts with a general contractor for the construction of the buildings and site preparation. In the real world, the contractor is often requested or pressured by the developer to begin construction prior to the final approval of the construction loan. This is a very common occurrence. Most contracting jobs have tight time schedules, often with penalty clauses for missed deadlines. Construction projects are very time sensitive and usually very competitive. Should the contractor decline to begin the work prior to the construction loan being closed, he will find his job in the hands of his competitor. So the contractor begins work, dedicates his time and resources and enters into contracts with his subcontractors. In some cases he may need to secure financing for extra equipment or supplies as well. Then the environmental assessment report is returned and it reveals that a very small portion of the property was once contaminated with PCBs. Although the dump site has been cleaned up, the lender refuses to proceed with the loan because of his concern for CERCLA liability. PCBs are an obvious case of an environmental hazard, however, lenders have been known to pull out less severe reasons such as a leaking umderground storage tank, and concerns over the handling of waste oil.

While environmental assessments are becoming commonplace, indeed I routinely recommend all my clients involved in land transactions have them done, the consequences of these studies and the conclusions being drawn from them are a serious issue. Banks and other lenders, quite frankly, are making prudent decisions in not proceeding with loans which might expose them to CERCLA liability. Unfortunately, the bottom line is that construction and other small businesses in general are denied the necessary capital.

The result of all this is that the owner in the above scenario now has no money to pay the contractor. The contractor thus becomes the biggest loser. He loses the profits on the job and, because he dedicated resources, he must absorb the loss of the funds invested outright, and he now has no place to turn until another job comes along. Equally significant, his employees have no work and his subcontractors and their employees have no work. Furthermore if the owner was a small business, perhaps an operator of gas stations or a dry cleaner seeking to expand, their business is curtailed as well. Because contracts have been signed, potential for litigation is great and additional dollars are spent either attempting to negotiate a settlement or in arbitration.

What I have just described is an actual construction industry scenario. I suspect it happens more often than we care to know. It is a tragedy not only for the lender and borrower, but obviously for the small business contractor, his employees and their families.

Current legal interpretations of CERCLA on the lender liability issue have placed the lender in the position of the owner. We believe this is wrong. I know of no commercial lender who wants to be an owner. More importantly, I know of no owner who wants his lender to run his business for him. CERCLA, however, has put the lender in the untenable position of being liable for his customer's hazardous waste practices and other environmentally sensitive practices. The lender becomes, at a minimum, much more cautious and conservative in his lending. This results in the cost of a typical financing being increased as much as $10,000 or more (the bankers do not absorb the cost of the environmental assessments). This may result in closings being delayed or cancelled with the ripple effect hitting the contractors.

The need for legislation such as H.R. 4494, has been brought home by a recent decision; a case of first impression from the Eleventh Circuit Court of Appeals. The opinion in the Fleet Factors case held that a lender was liable under CERCLA because of the lender's participation in the financial management of the facility to a degree which indicated the lender's capacity to influence the owner's treatment of hazardous waste. In other words, if a lender participates in the financial--as opposed to operational--management of a facility to the extent that it could affect hazardous waste disposal decisions there may be liability to the lender. Thus, the lender with the mere authority to influence a decision regarding waste can now be held strictly liable under CERCLA. In real terms this means every lender can be liable as they can always use that leverage to direct or influence the activities of the borrower.

I am certain this decision has sent tremors through the financial community. I am equally convinced that it will not only tighten credit availability for developers and contractors and other small businesses, but it will make what credit will be available more expensive.

We support you, Mr. Chairman, in your efforts to bring some rationality and reasonableness to this issue. H.R. 4494 is a sound piece of legislation. It is, we believe, a reasoned approach to the solution of a difficult problem which affects small businesses everywhere.

Thank you for this opportunity to address your committee on this matter, I will be happy to answer any questions.

TESTIMONY BEFORE THE U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

Delivered by JOHN T. JOHNSON, President and C.E.O.,

Miners Bank of Butte
Butte, Montana

June 7, 1990

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. GOOD MORNING.

I AM JOHN T. JOHNSON FROM BUTTE, MONTANA AND PRESIDENT OF MINERS BANK OF BUTTE. OUR BANK IS A FINANCIALLY SOUND, SMALL, RURAL BANK. THE BANK'S TOTAL CAPITAL IS $2,500,000.00.

IN 1980 OUR BANK EXTENDED A $200,000.00 WORKING CAPITAL LOAN AND A $275,000.00 SBA GUARANTEED TERM LOAN TO MONTANA POST AND POLE, A TELEPHONE POST AND POLE TREATMENT COMPANY LOCATED IN BUTTE. DUE TO CHANGES IN FEDERAL LOGGING REGULATIONS, MONTANA POST AND POLE WAS UNABLE TO REMAIN IN BUSINESS. THE COMPANY DEFAULTED ON ITS LOAN TO THE SBA AND TO MINERS BANK IN EARLY 1984.

IN JUNE OF 1984, WITH THE ASSISTANCE OF THE SMALL BUSINESS ADMINISTRATION AND WITH THE CONCURRENCE OF THE OWNERS OF MONTANA POST AND POLE, MINERS BANK FORECLOSED ON CHATTELS AND RECEIVED A DEED IN LIEU OF FORECLOSURE ON A PORTION OF THE PLANT SITE OWNED BY MONTANA POST AND POLE. THE BANK THEN WROTE OFF THE DEBT. AFTER REALIZING THAT THE PROPERTY WAS WORTHLESS AND WITH THE ACQUIESCENCE OF SBA, MINERS BANK RETURNED THE DEED TO THE OWNERS OF MONTANA POST AND POLE IN SEPTEMBER OF 1984 AND RELEASED ALL ITS CLAIMS TO THE REAL ESTATE. THE DEED TO THE BANK WAS NEVER RECORDED AND, AS A RESULT, MINERS BANK CONTENDS THAT TITLE TO THE PROPERTY NEVER ACTUALLY TRANSFERRED TO THE BANK.

EVEN SO, AND ON THE BASIS OF THE BANK'S ALLEGED AND DOUBTFUL THREE MONTH OWNERSHIP OF A PORTION OF THE PLANT SITE PROPERTY IN 1984, THIS PAST FEBRUARY, SOME SIX YEARS LATER, OUR BANK WAS ONE OF THREE PARTIES NAMED AS A P.R.P. OR (POTENTIALLY RESPONSIBLE PARTY) BY THE E.P.A. AND THE STATE OF MONTANA ON THE POST AND POLE SITE. **THE TRULY RESPONSIBLY PARTY**, THE OWNERS AND OPERATORS OF MONTANA POST AND POLE, ARE VIRTUALLY JUDGMENT PROOF. THE OTHER PARTY IS ONE OF AMERICA'S LARGEST CORPORATIONS; ARCO. WE BELIEVE THAT THE STATE AND E.P.A. EXPECT MINERS BANK TO PAY A SUBSTANTIAL PORTION OF THE TOTAL COSTS OF CLEANING UP THE MONTANA POST AND POLE SITE.

THE PRE-CLEANUP COSTS ON THE SITE ARE PROJECTED AT $1,200,000.00. THE ACTUAL CLEANUP COSTS AT THE SITE ARE PROJECTED TO BE ABOUT $8,750,000.00. THE TOTAL BILL FOR THE CLEANUP WILL THEREFORE BE ABOUT TEN MILLION DOLLARS. IF MINERS BANK IS FORCED TO PAY ONE HALF OF JUST THE PER-CLEANUP COSTS AT THE SITE, OR $600,000.00, THE BANK'S CAPITAL WILL BE "IMPAIRED," AND THE BANK WILL, TO USE A BANKING TERM OF ART, BE UNDER CLOSE REGULATORY SCRUTINY. IF THE BANK IS FORCED TO PAY AS MUCH AS $1,500,000.00 IN THIS PROCESS, THE BANK COULD BE JUDGED TO BE INSOLVENT BY THE REGULATORS. THE BANK SIMPLY DOES NOT HAVE THE RESOURCES TO PAY EVEN A SUBSTANTIAL PORTION OF THE CLEAN UP COSTS. AS I STATED, OUR TOTAL CAPITAL IS ONLY $2,500,000.00.

IN 1984 OUR BANK USED ENVIRONMENTALLY ACCEPTABLE LOAN MANAGEMENT PRACTICES. FOR EXAMPLE, THE DESCRIPTION ON THE DEED GIVEN TO THE BANK WAS FOR A PORTION OF THE SITE THAT WE BELIEVED WAS NOT CONTAMINATED. WE WORKED CLOSELY WITH THE SBA AND UNDER ITS DIRECTION IN HANDLING THIS PROBLEM SBA LOAN. WE ATTEMPTED TO ACT PRUDENTLY. THE MANAGEMENT PRACTICES THAT WERE ACCEPTABLE SIX YEARS AGO NOW APPEAR TO BE THE DEATH KNELL OF MANY SMALL BANKS AND SMALL BUSINESSES ACROSS THE UNITED STATES.

I WANT YOU TO KNOW THAT AS A P.R.P., OUR SMALL BUSINESS HAS PAID OUT OVER $100,000.00 IN LEGAL AND TECHNICAL SUPPORT EXPENSES SINCE FEBRUARY 1 TO DEFEND ITSELF IN THIS MATTER. THIS EXPENSE WILL MATERIALLY IMPACT THIS YEARS EARNINGS.

COUNSEL TELLS ME THAT, IN A MAJOR JUDICIAL DECISION RENDERED JUST LAST WEEK, THE ELEVENTH CIRCUIT COURT OF APPEALS SAID THAT CONGRESSIONAL, LEGISLATIVE HISTORY ON INNOCENT LENDER LIABILITY IS, AT BEST, SPARSE.

I ASK YOU THIS QUESTION: IS IT THE INTENT OF CONGRESS TO BANKRUPT INNOCENT SMALL BUSINESSES, INCLUDING INNOCENT SMALL BANKS, IN THE NAME OF CLEANING UP A WASTE SITE WHEN THOSE INNOCENT BUSINESSES HAD NOTHING TO DO WITH POLLUTING THE SITE?

IF SO, SMALL BANKS CANNOT RISK LENDING MONEY TO MANY SMALL BUSINESSES AND IT WILL HAVE ITS NEGATIVE EFFECT ON ECONOMIC GROWTH IN OUR NATION. THIS WILL BE PARTICULARLY TRUE IF FEDERAL LOAN GUARANTEE AGENTS SUCH AS THE S.B.A. ARE EXEMPTED FROM LIABILITY BUT SMALL BANKS ARE NOT.

I JOIN THE COURTS IN SEEKING YOUR CLEAR DIRECTION.

THE FARM CREDIT COUNCIL
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DENVER OFFICE:
P.O. BOX 5130
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STATEMENT OF ROBERT EGERTON
PRESIDENT, FARM CREDIT OF NORTH-CENTRAL N.Y., ACA
BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS
JUNE 7, 1990

Mr. Chairman and members of the Committee. My name is Robert Egerton, and I am President of the Farm Credit Association of North-Central N.Y., a farmer-owned credit institution which has almost 2,000 farm loans outstanding in 8 counties in central and northern New York State. Presently loan volume is close to $105 million. I am also here representing other Farm Credit lending institutions within the Springfield Farm Credit District, as well as the National Farm Credit Council, the System's trade association to express our collective views relative to lender liability under the superfund, or CERCLA law.

By its very nature, Mr. Chairman, farm lending is inherently a risky business. Commodity supply/demand imbalances leading to large fluctuations in price, weather, disease, and related unforeseen problems can often create financial problems for the borrower, and for the lender if not adequately protected. These are problems that all lenders expect to deal with and to a great degree anticipate or plan for. The potential for unforeseen and unlimited liability under CERCLA, however, is a risk which is extraordinarily difficult to deal with except through the denial of credit. What is of particular concern is the significant cost of environmental clean up following changes in previously approved practices, even though all applicable laws and regulations were followed at the time. An excellent example is the cost presently incurred for federally mandated asbestos removal, which was an approved, and in fact recommended or required insulating material 25 years ago. Such is the case also with many agricultural chemicals which were at one time approved for farm use. Property which has been contaminated can easily turn out to be an environmental time bomb; even after a lending institution has sold the propoerty, with the cost of clean up far exceeding the value of the property itself.

I want to make it clear, Mr. Chairman, that the Farm Credit system supports the environmental cleanup mission of CERCLA, but its enforcement efforts are misdirected at lenders, who are not equipped for or in a position to monitor or enforce compliance with environmental laws. It appears that lenders are viewed as "deep pockets" and the source for funding cleanup costs. Mr. Chairman, I know of many examples of farm mortgage loans which would have been made except for the concern over the possible contamination of the property. I also know of situations in which Farm Credit sustained significant financial losses due to a delay of foreclosure or by not exercising their rights to foreclose due to concern over unlimited liability under CERCLA. I will highlight these examples:

* A few years ago, one local Farm Credit Association foreclosed on a large fruit farm. Subsequently a pesticide storage building with a leaking roof was found on the property. Before the parcel could be sold, the material including shavings from the wooden beams and barn floor soil had to be disposed of. Disposal of the material has thus far cost in excess of $60,000 and the association has set an additional $200,000 aside to defray costs of additional clean up which may be required even though the association no longer owns the property.

* In the Midwest, a lending association made a loan secured by a farm. After the loan was made, a stream running through the farm was found to be contaminated with PCBs from a nearby chemical plant. Neither the borrower nor the lender were at fault. For unrelated reasons, the borrower defaulted on this loan, and the lender opted not to foreclose due to CERCLA liability as the estimated cost of cleaning up the property far exceeded the value of the property. Eventually the lender compromised about $200,000 of debt.

* One Association recently received a loan request from a farm borrower who wanted a mortgage loan to defray the cost of disposing of several barrels of waste found illegally dumped on his property without his knowledge. The Association opted not to make the loan due to potential liability. A few years ago, such a loan would have been made. Clearly this type of action is counterproductive, but it is one that the lender was forced to take due to concern over the lender's and the applicant's liability. In this case there was liability without fault, and the potential for unlimited liability prevents a responsible citizen from cleaning up a problem for lack of sufficient credit.

* During the course of a lengthy foreclosure proceeding on a 188 acre farm, local rumors indicated that the farm's water supply was contaminated. The Association was forced to consider whether to walk away from its $170,000 investment in the property or run the risk of being liable for a toxic cleanup where the ultimate cost was unidentifiable. The foreclosure sale was postponed for six months while the necessary research was conducted. The Association proceeded with the foreclosure and subsequently resold the property, but the delay cost the Association several thousand dollars in interest costs, legal fees, and labor costs to fully assess the business risk in ownership of the property.

* A poultry operation has requested a mortgage loan. Due to documented evidence that nitrate pollution exists in the water table, the loan will not be made. Should a single individual or a local credit institution be expected to cleanup such contamination?

* At the end of a protracted bankruptcy/foreclosure case with a large dairy farm, the owner delayed the foreclosure sale by simply hinting that the farm's water supply might be contaminated from nitrates from corn fertilizer on adjacent fields. This was a serious issue because the farm could be nearly worthless without water and the potential cleanup costs could be significant. How do you, for example, "clean up" years of nitrate buildup in crop soils? Only after further detailed investigation revealed that the water was fit for consumption, did the Association buy the property at the foreclosure sale and then subsequently resell it to an interested buyer, but not without the added costs of testing for contamination.

* One of our local Farm Credit Associations had received a loan request from a small farmer for a mortgage. A walkover assessment was done and no obvious signs of contamination were noticed. Later, the farmer was found by the State Environmental Agency to have been allowing refuse to be dumped on the land. The loan was never booked, but the Farm Credit institution could have been held liable for clean-up had it booked the loan and eventually taken title to the property even though there was no evidence of dumping when the assessment was done. It is extremely difficult for a lender or potential lender to police the daily actions of a borrower, especially in regard to land use.

* A local association is about to foreclose on a farm loan where the property is located adjacent to a junkyard. The amount of this loan is approximately $450,000. The property is being checked at this time, and it is possible that the association will opt not to take title to the property in order to avoid liability under CERCLA. If so the association could face significant financial loss.

These examples illustrate, Mr. Chairman, the real financial hazards associated with farm lending in light of environmental liens and liability concerns. Making the lender the environmental enforcer has the following adverse consequences: (1) the role is unfair to the lender as his/her business is credit, (2) the courts are turning the "without-fault" liability theory of CERCLA into a "lender's liability lottery" in which a lender is unable to predict when or if liability will attach resulting in a chilling effect on lending, and (3) the costs to lenders generated by monitoring compliance and environmental liability are passed on to borrowers in the form of increased interest rates, so many "innocent" borrowers pay for those who are guilty. Even the so-called "guilty" parties may have done nothing wrong, though they are held responsible. They may have simply been caught in changes of regulations or from proximity to environmental lawbreakers over which they had no control. In addition, lender's liability for environmental laws is choking off credit to creditworthy applicants in situations where environmental problems are merely suspected and in cases where credit may be the only source of cleanup funds. Furthermore, many of these applicants are small businesses with limited access to credit.

In order to help insulate our credit institutions against loss from potential environmental hazards, Farm Credit institutions within the Springfield District now require that as a minimum, an environmental checklist be completed on all new mortgage loans, and any refinancing of existing loans. The questionnaires, which are signed by the borrower, may result in a request for a Phase I environmental assessment to be completed by an independent engineer before a loan is extended. A more extensive survey can be required if major pollution of the site is suspected. These surveys are costly and range in price from $1500-$3000 for the Phase 1 walk-over, to $6500-$10,000 for the more detailed Phase II and Phase III investigations. This cost is borne by the borrower. Similar environmental risk management guidelines have been developed for use by other Farm Credit institutions.

A lender's decision to take title to property often rests on the quality and reliability of environmental consultants' reports. Consultants are unregulated, and through mistake, testing errors, or inexperience, lenders can be innocently held liable. Often then the best course of action for a lender where there is a suspected problem is to walk away from the collateral or not make a loan.

In conclusion, Mr. Chairman, the Farm Credit System institutions support your legislation (H.R. 2085) to limit Superfund liability of financial institutions and thereby restore the opportunity for farmers and other small businessmen, located in areas of possible hazardous waste contamination to obtain loans. While we would agree that all citizens must be good stewards of the environment, the cost for clean-up resulting from a change in regulations or contamination beyond the control of the property owner or lender should be borne by all of society. A recent study commissioned by the N.Y. legislature on credit availability found that there are problems with the availability of credit in many rural areas of New York. The increased risk to a lender under CERCLA will likely exacebate an already difficult situation and further hamper progress in rural development.

In closing, I would like to echo what has been stated by other lenders, and that is that "there is no comfort in waiting for the case law to determine liability", especially in view of recent court decisions such as that against Fleet Factors Corporation as reported in the May 29TH issue of The Wall Street Journal. To do so will only mean that lenders will be forced to deny credit to borrowers who otherwise would be eligible for loans were it not for lender liability.

Thank you for introducing H.R. 2085 and for the opportunity to share these thoughts on behalf of the Farm Credit System.

PREPARED STATEMENT OF
James P. O'Brien
for the hearing on H.R. 4494
before the House Committee on Small Business
June 7, 1990 at 10:00 a.m.

Good morning Mr. Chairman and members of the Committee. My name is James O'Brien and I am a participant in the Chicago office of the law firm of Chapman and Cutler. Chapman and Cutler represents a number of banks and institutional lenders in secured lending transactions. As an environmental lawyer, I am frequently called upon to help our lender clients evaluate and address environmental risks in secured lending transactions. I have had the pleasure of serving as editor and an author of Environmental Due Diligence: The Complete Resource Guide, a 500 page book which addresses the issues before the Committee today. I appreciate the opportunity to provide my testimony to the Committee about the significant impact of Superfund on secured lending, and in turn, on the Nation's small businesses.

Environmental liability is a matter of utmost concern to banks and institutions which lend money to businesses, and in particular, small businesses. From my involvement in over $3 billion of transactions in 1989 alone, no issue has a higher priority for lenders, than the risks associated with environmental liability. Enormous amounts of time, effort and money are spent on environmental due diligence in financial transactions. By environmental due diligence, I mean the process of investigating, evaluating and addressing the environmental issues in a financial transaction.

As the law now stands, the only way a bank can protect itself from environmental liability is to satisfy the so-called innocent landowner defense. That defense requires lenders to undertake "all appropriate inquiry" to find the contamination. EPA's interpretation of that defense, and the court decisions which construe it, however, are not consistent with the intent of Congress at the time of enacting

Superfund. Indeed, environmental lawyers in the government have likened the search for an innocent landowner to Diogenes in the daylight with his lantern: if the lender undertook all appropriate inquiry, and the contamination was found, then the lender was not an innocent landowner. If the lender did not find the contamination, then all appropriate inquiry was not made.

The result is a chilling effect on lending to businesses which are environmentally active and who do not have the money to spend on elaborate environmental due diligence. Businesses that carry on a process or a manufacturing activity which, through mistake or upset, could cause environmental contamination, are simply not worth the risk of liability, at any interest rate. As you have heard today, the costs of cleanup are catastrophic. The environmental risks associated with lending to a small business are no different than that associated with large lending transactions; it really is a matter of just adding zeros. In addition, if a transaction cannot support the fees necessary to undertake appropriate environmental due diligence, because the borrower is too small, then the lender cannot go forward.

In preparing the environmental due diligence book I spoke of, we surveyed lenders who were a party to almost three hundred multi-million transactions in 1988. The survey revealed that lenders believed 70% of those transactions surveyed were environmentally risky. Although the lenders identified a variety of different environmental risks, all lenders surveyed identified lender liability for cleanup costs as owner through foreclosure as a top environmental risk. In response to those risks, lenders identified a variety of steps used to minimize risk. All of the lenders used environmental audits or property assessments to address the problem of environmental risks, the costs of which ranged from $1,500 to $25,000, and averaged $4,500. Based upon those survey results, we projected that approximately $418 million will be spent on environmental audits for environmentally risky transactions through the 1990s. In addition to all of the other costs and fees charged in a lending transaction, borrowers will spend over $400 million simply to provide comfort to lenders on environmental risks.

You probably will not be surprised to hear that this issue has created a new industry of environmental consultants performing assessments or audits. You may be surprised to learn that it also has created a new legal specialty. Recently, I had breakfast with a Washington lawyer who described himself as "an environmental due diligence lawyer." Almost all of his practice, and that of several other lawyers in his firm, involved environmental due diligence issues in financial transactions.

Can the small businesses in this country support the growing legal and consulting industry in environmental due diligence? I suggest not. A small business borrowing $100,000 hardly can afford to pay $4,500 for an environmental assessment. Moreover, that is assuming the lender is willing to loan the money on any terms.

This problem has not been made up. The broad reach of liability under Superfund, forces lenders to look to the innocent landowner defense for protection. The requirements of that defense ends up costing borrowers thousands of dollars in consultants and lawyers fees, which fees have no relation to the size of the borrower. Nevertheless, despite all of the money spent on environmental due diligence, EPA interprets the defense in a way which gives it no meaning at all. As court decisions continually expand theories of lender environmental liability, lenders seriously question whether to make a loan, at any price and even after extensive due diligence.

My testimony today is directed at the legal issues associated with Superfund liability and the innocent landowner defense. I first review the environmental risks posed to lenders in financial transactions. I next discuss the innocent landowner defense, the only defense currently available, and EPA's interpretation of, and court decisions concerning, that defense. In particular, I focus on a recent decision which, if allowed to stand, could significantly expand the scope of lender liability. I conclude my testimony with a statement of support for the pending legislation and my view on how it addresses the problems raised.

Introduction

Environmental law changes quickly, usually in the direction which broadens its scope and applies stricter requirements. As these changes are picked up in the press, the public perception is that environmental law deals with cleanups and permits. Federal, state and local governments are now moving toward cleaning up the results of years of chemical mishandling and bad housekeeping. In addition, permits are required to make sure that future clean ups will not be necessary. Although simplistic, that perception is not too far from the thrust of the law.

The important difference for lenders is the broad impact upon transactions from these basic changes. In many ways, the environmental laws are taking on aspects of land use regulation, product liability law and general tort law. The laws affect land use in a direct way, in that the emission of certain kinds of wastes must be permitted, thus affecting the kind of industry that may be carried on. Land use can be indirectly affected in that risks associated with the laws may drive the kinds of preparation of the property or even location to the property to carry on the planned business. For example, the risks of clean up costs may drive the lender to require clean collateral before lending to the borrower. Or the lender may not be willing to finance a manufacturing facility located near a subdivision of residential homes. Similarly, like product liability law, the environmental laws can make certain kinds of businesses too expensive to carry on. Businesses may be so environmentally active that lending transactions are, practically, too expensive to undertake. Very few lenders would be willing to participate in a secured transaction where the collateral is a dumpsite, without extensive environmental investigation and review. Even then, the lender probably would require some other financial back stop for the outlay. Finally, the health risks which underlie the environmental laws, add a common law tort dimension. In another words, if there are health risks associated with the business, and people are injured, there could be liability for the personal injury damages suffered. All of these nuances, although not part of clean ups and permitting, do affect lenders undertaking secured transactions.

At the heart of the law, however, are cleanups and permitting. The two major directions of federal legislation are cleaning up existing contaminations and preventing future contamination. The clean up statutes are broad and attach liability based upon status, rather than action. In other words, like a taxing statute, responsible parties pay because of the status or classification applicable, rather than because it is fair and equitable to require this party to pay so much. In addition, the bureaucracy charged with administering the clean ups is also charged with spreading the costs among private parties on a broad basis. Since liability under the statute does not depend upon whether it is fair to hold a particular party responsible, it is more fair to seek costs from as many parties as possible; generally, that is the perspective of the government lawyers looking for deep pockets.

In addition, since environmental regulation begins with legislation coming out of the political process, it is not surprising to find that the permit statutes are confusing and complex. Statutes overlap, are inconsistent and include provisions which may reflect certain constituencies. Moreover, the perceived problem with certain regulators has resulted in detailed, specific legislation including timetables for regulatory action which are usually not met. The effect is that businesses operating under the regulations must proceed, after advice from lawyers with tarot cards, at their own risk. Lenders, of course, must satisfy themselves that the businesses can continue to operate economically under those regulations.

Environmental Risks to Lenders

This section summarizes the risks associated with environmenal liability to lenders. Generally, the material discusses the issue from the perspective of the kinds of facts or circumstances the lender might encounter. For example, what environmental risks do lenders confront when lending money to a borrower? The sources of the risks are laws and statutes, which are discussed later in this statement.

The environmental risks in a secured lending transaction can arise in two ways: liability for cleaning up contaminated property and the liability associated with violating environmental quality laws. The risks associated with the liability for clean up costs are of two kinds. First, the lender's outlay may be at risk because the cost of cleaning up the property may exceed the financial ability of the borrower to pay. Second, depending upon the lender's activities during the term of the loan, and sometimes the structure of the transaction, the lender can be liable for the costs of cleanup.

The risks of clean up costs can be caused by four different activities. First, the operations and processes carried on by the borrower or current owner may be environmentally active, in that regulated substances were used or thrown off as wastes. There may be costs associated with cleaning up the property, or costs to clean up an offsite facility to which the wastes were hauled. For example, if the business generates liquid wastes which are treated by a lagoon or surface impoundment, there may be soil excavation and groundwater remediation costs if there is a leak. Once the contaminated soils are cleaned up and sent to a landfill, there is still a risk of liability if that landfill eventually must be cleaned up. Similarly, even if the business always sent its wastes to an offsite dump, there could be clean up costs charged against the business if the offsite facility leaks. Under CERCLA, the owners of the property where hazardous substances are released are liable, as well as the generator of those wastes.

Second, the contamination can be due to substances put on the property by a past owner or operator, before the borrower or the purchaser commenced operations. There could be a discovery of "buried treasure" which must be cleaned up, even though the current owner had nothing to do with the past disposal practices. Many industrial facilities used underground storage tanks to keep fuels and materials necessary for the plant. As an improvement to the property, the tank usually does not appear on building plans and specifications, or in the blueprint drawings. Because of corrosion and shifting soils, the tanks almost inevitably leak after fifteen to twenty years of use. Thus, by the time the new owner purchases the property, there is no record of an underground tank which is leaking fuel or product into the soils and groundwater. The new owner is nevertheless liable for the costs of clean up.

Third, substances could have been put on the property by a "midnight dumper," who wrongly used the property to dispose of wastes. Particularly at undeveloped parcels or former agricultural land, it is not unusual to find dumping by local residents. Presumably, the household trash and debris is not a serious environmental hazard. Many household appliances and automobile parts contain toxic hazardous substances, however, and there is a real risk associated with the dumping. Moreover, during the late sixties and early seventies, rising costs of landfills and new restrictions on acceptance of wastes caused many haulers to look for alternative disposal sites. With or without the consent of the owner, disposal of industrial and manufacturing wastes in gravel pits and old quarries was fairly common. In the industrial sections of the country, particularly in the northeast and midwest, industrial facilities tend to be located near one another, along with mixed residential use. Even if the manufacturing use changes, the industrial history of the property extends back 80 to 100 years ago. Waste that was dumped out the back door then, is now affecting or impacting the environment. Since it is almost impossible to find the culprit, or many times the source, affected property owners must take steps to clean up. In addition, as use changes, and residences are located near to the plant, the neighborhood becomes more sensitive to traveling contamination.

Finally, the substances can be traveling onto the collateral or property from the property of an adjacent landowner. Generally, this problem arises from subsurface contamination leeching onto the collateral or affecting groundwater which passes under the collateral.

The risk that the lender will be liable for the costs of clean up can arise from two situations: the lender is found to be either the owner or the operator of the contaminated facility. Currently, the lender can be liable if it forecloses on its security interest and takes title to the property. It is this scenario, among others, that the current legislation is intended to address. In addition, the lender can be held liable as an operator, if the lender becomes overly entangled in the day-to-day affairs of the borrower. Lender liability as owner or operator is discussed further below.

There is a third risk of lender liability as owner which arises out of the case entitled United States v. Fleet Factors Corp., Case No. 89-8094, slip op. (11th Cir. May 23, 1990). Discussed more fully below, Fleet Factors creates a new class of owner liability through the lender's security interest in the contaminated property plus some exercise of financial management. Assuming the Fleet Factors case stands, in its essence, it creates an ownership liability. The proposed legislation should address that case to the extent of ownership liability.

Generally, environmental liability is associated with the costs of cleaning up contamination. While operating an ongoing business which impacts upon the environment, the borrower also must comply with environmental quality laws. The liability for violating environmental quality laws can arise from failing to obtain a proper permit or for failing to comply with permit parameters. The development or construction may have required a permit, or may be adversely affecting critical environmental resources. In another words, the project may hit a "snail darter snag." This is usually referred to as the "bugs and bunnies" issues. In addition, the borrower or purchaser may have failed to obtain the proper operating permits associated with the business, and may be forced to install expensive pollution control equipment. The borrower or purchaser also may be violating the restrictions established in its operating permits. In each instance, there could be liability for civil and criminal penalties, and damages for injury to natural resources and the environment. Although the lender should not be liable for these kinds of costs, unless it continues to operate the business after foreclosure, it could be a credit issue depending upon the borrower and the nature of its business.

Lender liability as owner or operator.

The lender's interest in the collateral is inchoate or one step removed. In other words, the lender could become the owner or operator, but when it closes the loan, all that usually has happened is that the lender has received a bundle of rights or remedies which later can be invoked. The lender is really not the owner or operator of the business and property, and the environmental laws generally recognize the lender's role as a financer, rather than an operator of a business. The lender sometimes crosses the line, however, and become an owner or operator of the contaminated facility. This section discusses those instances in which the lender becomes liable for clean up costs as an owner or operator of the contaminated property.

Other than in certain title states, the lender is not the owner of the property which serves as collateral. Instead, the lender has an inchoate interest which can be realized upon through foreclosure. The whole point of collateralizing an obligation is that the lender can look to the property to satisfy the borrower's obligation. Yet, the lender has only contractual rights which become enforceable only after a declaration of default and with the assistance of the courts. Because of the leverage of a default, practically, the lender can exert influence over the affairs of the borrower. The difficulties with this participation in the borrower's affairs are discussed below. Assuming that the lender has not become involved in the borrower's business, then the most a lender can do about the borrower's mishandling of chemicals is to decide whether to declare a default.

The environmental laws and the legislative history recognize the limited role of a secured lender. Under CERCLA, the definition of "owner and operator" does not include "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." 42 U.S.C. §9601(20)(A). Courts have held that a perfected security interest in the property of the borrower is not enough to hold a lender liable as an owner. In re T.P. Long Chem. Inc., 45 Bankr. 278 (Bankr. N.D. Ohio 1985); United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986). This approach is consistent with the legislative history of CERCLA. The passages are very illustrative of legislative intent. For example, the report of the Committee on Merchant Marine and Fisheries reported on an early draft of CERCLA that an owner did not include parties holding title to secure a loan:

> "Owner" is defined to include not only those persons who hold title to a vessel or facility but those who, in the absence of holding a title, possess some equivalent evidence of ownership. It does not include certain persons possessing

> indicia of ownership (such as a financial institution) who, without participating in the management or operation of a vessel of facility, hold title either in order to secure loan or in connection with a lease financing arrangement under the appropriate banking laws, rules or regulations.

2 CERCLA Legislative History 546 (emphasis added). The House Report is even more expansive than the report from the Committee on Merchant Marine and Fisheries:

> "Owner" is defined to include not only those persons who hold title to a vessel or facility but those who, in the absence of holding a title, possess some equivalent evidence of ownership. It does not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a vessel or facility, hold title either in order to secure a loan or in connection with a lease financing arrangement under the appropriate banking laws, rules or regulations.
>
> Owners form one of the three major classes (the others being operators and guarantors) subject to liability under the Act. For example, a financial institution which held title primarily to secure a loan but also received tax benefits as the result of holding title would not be an "owner" as long as it did not participate in the management or operation of the vessel or facility. (Emphasis added).

H.R. Rep. No. 172, 96th Cong. 2d Sess., at 36, reprinted in 1980 U.S. Code Cong. & Admin. News 6181. Unfortunately, no legislative history has been found regarding the degree of "participation in the management or operation" of a facility necessary to incur liability as an "owner." However, common sense dictates the level of control necessary to be deemed an "operator" of a facility may be equivalent to the level of participation needed to become liable as an "owner" under CERCLA:

> "Operator" is the second major class subject to liability under the Act. Operators of vessels do not include those individuals who are not totally responsible for the operation of a vessel. To fall within the definition, the individual must have assumed the full range of operational responsibility. For example, a pilot might be in charge of navigation of a vessel for a short duration, yet he does not meet the definition of "operator," since he neither mans nor supplies the vessel. In the case of a facility, an "operator"

> is defined to be a person who is carrying out operational functions for the owner of the facility pursuant to an appropriate agreement." (Emphasis added).

H.R. Rep. No. 172, 96th Cong. 2d Sess., at 36, reprinted in 1980 U.S. Code Cong. & Admin. News 6181-6182.

Thus, it appears that the legislative history suggests that the "owner or operator" must be a person that possesses some evidence of ownership, other than a security interest, or one that is totally responsible for the operation of the facility. Burcat, Environmental Liability of Creditors: Open Season on Banks, Creditors, and other Deep Pockets, 103 Bank. L. Journal 509 (1986).

Until recently, the case law recognized that the lender has a financial stake in the property, and can take steps to properly protect that interest, as long as those steps do not rise to the level of ownership or operatorship. Of course, the security interest exemption gives cold comfort to the lender; the lender is protected from liability while it holds a security interest, but once it attempts to realize on its security interest, then it is subject to liability.

This unfair result was made clear in United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986). In Maryland Bank, the court held that a lender who foreclosed on property can be liable for the costs of clean up. After the lender had foreclosed on the property and taken legal title, USEPA inspected the property and discovered hazardous wastes. The agency cleaned up the property using monies from the Superfund, and filed a cost recovery action against the lender. The court held that the security interest exemption did not protect the lender because the lender was a titled owner at the time the clean up funds were spent.

Similarly, a lender who participates in the day-to-day operational aspects of a facility may lose the protection of the security interest exemption and become liable for clean up costs. In United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994 (E.D. Pa. 1985), the court distinguished between the lender's participation in the financial affairs and decisions of the borrower, and participation in the management and operations of the facility. For example, the court granted summary judgment to a lender who only limited the borrower's financial activities, such as annual compensation, dividends and the purchase of life insurance. Another lender, however, participated in the operations of the borrower and was denied summary judgment. Those activities included visiting the plant once a week, determining the priority in which orders were filled, insisting on certain manufacturing changes and reassignment of personnel, and requiring day-to-day supervision by a person selected by the lender. The court noted that the lender may have become overly entangled in the operational affairs of the borrower, and participated in the management of the facility.

Lenders can attempt to protect themselves from environmental liability by conservative and limited lending; office and residential buildings are not environmentally active uses of property and should present little risk of liability. Or the lender can attempt to evaluate the risk of environmental liability in a transaction involving a factor or manufacturing facility. The difficulty is that EPA has interpreted the available defense so that it has no meaning at all. In theory, there should be protection from liability. The next section of my testimony addresses the innocent landowner defense as it should operate, as the courts have construed it, and finally, as EPA has viewed the provision.

The Innocent Landowner Defense.

The statutory mechanism available to protect the lender is the innocent landowner defense. The situations in which this issue can arise are examined below.

First, assume that the contamination is discovered prior to the time of foreclosure or purchase on the affected property. In that situation no liability will attach as long as the property is not foreclosed upon or purchased. Under the terms of the Superfund Act, known as the Comprehensive Environmental Response, Compensation and Liability Act or "CERCLA," 42 U.S.C. S9607(a), the "owner and operator" of the facility will be liable for the costs of clean up. The term "owner or operator" is defined at 42 U.S.C. S9601(20)(A) to mean "any person owning or operating" the facility, but does not include "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." Until Fleet Factors, the courts have interpreted this definition to mean that a mortgagee who does not foreclose upon the collateral has only a security interest in the facility, and falls outside the definition of "owner or operator." United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986); United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985); but see, Tanglewood East Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568 (5th Cir. 1988) (homeowners brought suit against lender to developer of subdivision, where subdivision was constructed on contaminated site of former manufacturer of hazardous substances). See also, Jersey City Redevelopment Auth. v. PPG Indus., 655 F. Supp. 1257 (D.N.J. 1987) (the court denied the defendant's summary judgment motion which argued that the innocent landowner defense should apply to wastes hauled from defendant's site to the contaminated site); Guidance V. BFG Electroplating and Mfg., Inc., C.A. 86-2093, slip op. (W.D. Pa. Sept. 1, 1989) (bank not operator of facility, although after foreclosure bank may be owner).

As most courts have construed CERCLA, if the property is foreclosed upon despite knowledge of the contamination, then the lender probably will be liable. Liability will attach because the lender is the owner or operator at the time part or all of the response costs are incurred. At least one court has disagreed with this view. In Coastal Casting Serv., Inc. v. Avon, Case No. 86-H-4463, slip op., 1988 W.L. 35012 (April 8, 1988 S.D. Tex.), the plaintiffs alleged that the defendant bank had foreclosed upon its mortgage in 1961 and then leased the property back to its borrower until 1964. Apparently, ownership of the property changed a number of times until the plaintiff purchased it in 1979. While a prospective purchaser was investigating the property in 1983, hazardous substances were discovered and the tract was placed on the National Priorities List.

In refusing to dismiss the complaint against the bank's successor-in-interest, the court noted that CERCLA imposes liability "on one who foreclosed on a property when active participation and exercise of control over essential operations of the site's facility bring that party within the statutory definition of owner or operator." The Coastal Casting court made clear in its opinion that foreclosure on the property is not enough to find the lender liable as an owner. Indeed, after citing Mirabile and In re Long Chem., Inc., 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,635 (Bankr. N.D. Ohio 1985) as support for the quoted statement, the court cited Maryland Bank as contra authority (using the "but see" signal).

The lender may argue that the hazardous substances were put there by a third party, prior to the time of ownership, and therefore no liability should attach. Under Superfund, there is an affirmative defense at 42 U.S.C. S9607(b)(3) which allows the owner or operator to escape liability where the hazardous substances were put on the property by a third party. The owner or operator may not utilize the third party defense, however, where the third party has a "contractual relationship, existing directly or indirectly, with the defendant." Id. The lending relationship between the lender and the site owner is a contractual relationship which will prevent the lender from using this defense. Maryland Bank, 632 F. Supp. at 581. Courts have construed the phrase "contractual relationship" broadly, thereby narrowing the third party defense. City of Philadelphia v. Stepan Chem. Co., Nos. 81-0851, 83-5493, slip. op. (E.D. Pa. July 28, 1987).

Thus, in the situation where the contamination is discovered prior to foreclosure, there will be no liability as long as the lender does not take title to the property. While the lender will not be exposed to environmental liability, it will also lose the value of the property, whether as collateral or as part of the expected benefit of the transaction.

Next, assume that the contamination is discovered after the lender takes title to the property. Whether liability will attach in that situation depends upon what steps the lender took prior to taking title to determine whether the property was contaminated. If the lender can show that it made all appropriate inquiry into the past ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability, and the contamination was not discovered at that time, then liability should not attach for the cost of clean up.

As discussed above, the owner or operator of a facility is liable for clean up costs where those costs were incurred during the time of ownership. 42 U.S.C. §9607(1). The owner or operator will not be liable, however, where a person can establish by a preponderance of the evidence that the contamination was caused solely by an act or omission of a third party. Since the lender or purchaser took possession of the property after the contaminants were put on the property, then this requirement is satisfied. The third party defense is not available, however, where the lender or purchaser had a contractual relationship with the previous owner. Under the original Superfund statute, the lending relationship between the lender and the borrower would have prevented the third party defense from being utilized.

Although the statute is meant to be a strict liability statute, so that liability attaches regardless of fault, this result seems unfair and unjust. The statute would assign liability, although the lender had no knowledge that the property was contaminated, and had nothing to do with the operation of the property at the time of the contamination. This concern was addressed by the Superfund Amendments and Reauthorization Act of 1986 ("SARA"), which provided that an innocent landowner will not be considered to be in a "contractual relationship" with the previous owner. Under 42 U.S.C. §9601(35)(A), the term "contractual relationship" includes any instrument transferring title or possession:

> [U]nless the real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substance on, in or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant by a preponderance of the evidence:
>
> (i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in or at the facility.
>
> . . . .
>
> In addition to establishing the foregoing, the defendant must establish that he has satisfied the requirements of §9607(b)(3)(a) and (b).
>
> (B) To establish that the defendant had no reason to know, as provided in clause (i) of subparagraph (A) of this paragraph, the defendant must have undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability. For purposes of the preceding sentence the court shall take into account

> any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.

This provision, which is usually called the "innocent landowner defense," should prevent the imposition of liability upon the lender for clean up costs. The lender also must satisfy the other elements of the third party defense, including exercising due care upon the discovery of the contamination. 42 U.S.C. S9607(c). At the least this will entail notifying appropriate authorities, and it may include some response costs to prevent imminent injury.

The legislative history behind the innocent landowner defense suggests it should be an effective mechanism to protect lenders in transactions. The conference report to SARA notes that the

> [N]ew definition of contractual relationship is intended to clarify and confirm that under limited circumstances landowners who acquire property without knowing of any contamination at the site and without reason to know of any contamination (or as otherwise noted in the amendment) may have a defense to liability under [42 U.S.C. S9607] and therefore should not be liable for cleaning up the site
>
> . . . .
>
> The duty to inquire under this provision shall be judged as of the time of acquisition. Defendant shall be held to a higher standard as public awareness of the hazards associated with hazardous substance releases has grown, as reflected by this Act, the 1980 Act and other Federal and State statutes.
>
> Moreover, good commercial or customary practice with respect to inquiry in an effort to minimize liability shall mean that a reasonable inquiry must have been made in all circumstances, in light of best business and land transfer principles.

H. R. Conf. Rep. No. 962, 99th Cong. 2d Sess. 186-187 (1986).

Although the original provision passed by the House was somewhat different than the conference compromise, the comments on the floor by House members are instructive. The following exchange took place between Representative Breaux and Representative Frank, who proposed the Amendment.

> MR. BREAUX. I thank the gentleman for offering his amendment. Let me ask a question, and perhaps the chairman of the committee may be able to respond, or the author of the amendment.
>
> Without the gentleman's amendment, am I to understand that a person would be able to buy property, a tract of land and have in the deed of conveyance a covenant that this property is transferred and there is no toxic waste located on this property, there is no way that person can visually find out or reasonably know that there is any kind of toxic waste underneath that property; and then 5 years or some time period down the road discover for the first time that that property has some toxic wastes that had been buried years before under his property, that without the gentleman from Massachusett's amendment that that property owner would then be somewhat held responsible?
>
> MR. FRANK. Let me respond by saying we are not sure of the answer to this. I think all of us would agree that you should not be held responsible. I would hope that frankly even under the current law you might ultimately be held not responsible, but no one can have that assurance.
>
> . . . .
>
> The only way to be sure that there would be no liability in the circumstances described by my friend from Louisiana would be to adopt this amendment.

131 Cong. Rec. 11075 (1985).

The situation described by Representative Breaux parallels the typical foreclosure situation.

In the two and one half years since SARA was enacted, there has been very little precedent from the courts as to who qualifies as an innocent landowner. A number of cases have addressed the factual circumstances underlying the claim for treatment as an innocent landowner.

The first case reviewing the facts of an innocent landowner claim is United States v. Louis Serafini, No. 86-1591, slip op. (M.D. Pa. Feb. 19, 1988). In Serafini, the court denied the government's motion for summary judgment finding that the innocent landowner defense may protect the defendants from liability. In that case, the defendants purchased a parcel of property in 1969 which had been used as a sanitary landfill and waste disposal site. In 1983 USEPA conducted an emergency action removing over one thousand one hundred drums containing hazardous substances from the site. The government then brought suit against the property owners for the costs of clean up. In its opinion, the court found the government had made a prima facie case for liability under the statute. The court then turned to the defendants' affirmative defense that the contamination was caused by a third party and that they were innocent landowners.

The government argued that the defendants had reason to know of the site's condition, because at the time they purchased the land in 1969 it was obviously and visibly contaminated, and any site visit would have revealed hundreds of abandoned drums on the surface. The defendants submitted affidavits, however, testifying that at the time of the purchase in 1969 they did not conduct an on-site inspection, nor did they have any reason to do so. They testified that the purchase involved the inspection of various maps to determine the location of the 225 acres and that it was not until 1980 or 1981, when USEPA conducted an investigation, that they became aware of the existence of the drums. The government countered that landowners cannot avail themselves of the innocent landowner defense by closing their eyes to hazardous waste problems. The government argued that the defendants had no knowledge of the clearly visible drums only because they failed to inspect the premises prior to purchasing it and they made no inquiry into the past uses of the site. The innocent landowner defense, the government suggested, does not protect the owner who fails to inspect the land or fails to inquire into its current condition or past history.

The court stated that after analyzing the factors set forth at 42 U.S.C. S9601(35)(B), the court was unable to find that the defendants' inaction was inappropriate under the facts of the case. The government presented no evidence from which the court could conclude that the defendants' failure to inspect or inquire was inconsistent with good commercial or customary practices. Thus, there existed unresolved questions of fact as to the propriety of the defendants' conduct at the time of the purchase. Therefore, the court denied the government's motion for summary judgment.

Importantly, the court did apply the innocent landowner provision as it was contemplated by the statute. Even though the court held that it was conclusively established that the drums were visible at the time of acquisition, the court focused on whether the defendants' inaction was appropriate inquiry under the statute. The lack of evidence concerning the appropriateness of the defendants' inaction was crucial to the court's holding that the government's motion would be denied. Under the court's reasoning, if the defendants' actions were appropriate and consistent with good commercial or customary practice, then liability would not attach. Similarly, if the lender makes appropriate inquiry at the time of foreclosure upon collateral, and no contamination is discovered, then under the Serafini holding, liability would not attach.

The government then filed a supplemental motion for summary judgment in the Serafini case, attaching two affidavits from real estate appraisers testifying that no reasonable purchaser of commercial property in 1969 would not have visited the site. If the defendants had visited the site, then they probably would have seen the drums. The defendants submitted counteraffidavits, testifying that it was not "customary and good commercial practice" to require inspection by a purchaser or fiduciary. See 42 U.S.C. §9601(35). The court again denied the government's motion, holding that a genuine issue of fact existed which must be resolved at trial. No. 86-1591, slip. op. (M.D. Pa. Aug. 31, 1988).

The second case to consider the facts supporting an innocent landowner claims is BCW Assoc., Ltd. v. Occidental Chem. Corp., No. 86-5947, slip. op. (E.D. Pa. Sept. 29, 1988). In a trial without a jury, the court refused to extend the protection of the innocent landowner defense to a purchaser and that purchaser's lessee, both of whom ignored obvious flags of contamination. In addition to obtaining a structural engineer's report, the purchaser also retained an underwriting firm to conduct an engineering inspection for insurance purposes. That firm reported that the buildings "are free of any hazardous wastes or contaminants." Slip op. at 3. The lessee also engaged an engineer, but decided not to test dust which had accumulated inside the purchased building because of the expense and the timing of the transaction. The lessee's engineers reported that the property appeared to be free of hazardous substances.

Later, it was discovered that the dust contained high levels of lead, and the property has to be cleaned up. The purchaser and the lessee paid the response costs, and then filed a cost recovery action against the seller and a previous owner. The evidence showed that it was the previous owner's operations which had generated the lead dust. The seller had purchased the property contaminated with the lead dust, carried on its business, then sold the property without having disturbed the dust, at least according to the court. On that basis, the court found the seller was not an owner or operator, and even if it was, it would not be liable for any portion of the costs after the court's application of "equitable apportionment" under 42 U.S.C. S6913(f).

The court then turned to the plaintiffs' claims against the previous owner. That defendant argued it was entitled to invoke the third party defense at 42 U.S.C. S9607(b), apparently because it was the plaintiffs who caused the release of the hazardous substances. Inexplicably, the reasons the court used to hold that the defense did not apply were that the defendant did not exercise due diligence with respect to the hazardous substances, and that the defendant did not take precautions against the foreseeable acts of third parties. Whether that faulty analysis was due to briefing or a misunderstanding of the nature of the defense, the proper basis for denying the defense to the defendant was that the so-called third parties, the plaintiffs here, were not solely responsible for the release. See United States v. Hooker Chem. & Plastics Corp., 680 F. Supp. 546, 558 (W.D.N.Y. 1988). The lead dust was first released by the defendant. Slip op. at 8.

In arguing that the defendant solely should be liable, the plaintiffs also invoked the third party defense against the defendant's counterclaim. Since the plaintiffs did not introduce the lead just into the warehouse, only the defendant should pay to cleanup costs. This seems to be the right result: the plaintiffs bought or leased property contaminated by the defendant's wastes, and should be able to recover the costs of cleanup. As a matter of law, the third party defense should protect against the defendant's contribution claim, while equitably the plaintiffs should not bear any part of the expense.

The court did not agree. The assertion of the third party defense was dealt with in the opinion with one line: "In light of [the owner's] knowledge concerning the dust in the warehouse and the nature of [the lessee's] activities [which disturbed the dust and in the court's mind led to the release], it cannot be said that it exercised due care or took adequate precautions," Slip op. at 20. There was not discussion of the sufficiency of the investigation, or the value of the engineer's opinion that the building was free of hazardous wastes. Instead, the court went on to weigh the equitable factors in apportioning liability. The economic benefit gained by the owner and the fact that the lessee ignored the dust, led the cour to conclude that each party should bear the burden of equally.

There is always a danger in construing cases using the maximum that bad facts lead to bad cases. If another court cites BCW for the proposition that clean engineering reports are not enough to utilize the third party defense, and in turn the innocent landowner defense, then this analysis will look naive. The court's rough sense of justice and the weight accorded equitable factors, however, suggests that the court was reaching a result it felt proper, rather than applying the law as written.

Of course, the BCW can be read consistent with the approach taken in this testimony to the innocent landowner defense. From that perspective, the plaintiffs were not entitled to the protection of the defense because of the obviousness of the contamination. The dust had accumulated in all the work areas of the building, and at least the lessee was suspicious of the dust. Slip op. at 2-3. Nevertheless, the plaintiffs and their engineers ignored the flag of potential contamination. If future courts view BCW as holding that an innocent landowner cannot rely upon an engineer's opinion which is obviously inconsistent with easily identified problems, then BCW provides helpful guidance. The difficulty is that the court did not address these matters in its opinion.

The "conventional wisdom" on the BCW case must await additional authors or other courts.

The innocent landowner defense was also considered in a slightly different context in Washington v. Time Oil Co., Nos. C85-478TB & C86-990TB, slip op. (W.D. Wash. Feb. 22, 1988). In that case, the court did grant the government's motion for summary judgment finding that the innocent landowner defense did not apply. There, the defendant had leased property to its subsidiary for a waste oil operation. In turn, the subsidiary had leased the property to a sublessee who also operated a waste oil business. The evidence established that the defendant's subsidiary had disposed of hazardous substances on the property and the sublessee had operated a very sloppy business, even to the point of prompting the defendant to seek a preliminary injunction to prevent the sublessee from continuing to contaminate the property.

In its opinion, the court found that the defendant did not prove that the release had been caused solely by a third party and that the defendant had exercised due care or took precautions with respect to the property. In order to utilize the innocent landowner defense, the defendant must show that a third party was responsible for the contamination, and that the defendant exercised due care with respect to the property. While this opinion does not address the all appropriate inquiry standard, the case does demonstrate that courts will look to the plain meaning of the innocent landowner defense when construing the defense.

One court has suggested that the legislative history from the SARA amendments demonstrate that Congress intended to create a three-tier system of appropriate inquiry: Commercial transactions are held to the strictest standard of inquiry; private transactions are given a little more leniency; and inheritances and bequests are treated the most leniently of these three categories of transfers. United States v.

Pacific Hide & Fur Depot, Inc., Civ. No. 83-4052, slip. op. (March 10, 1989 D. Id.). In Pacific Hide, the court granted the defendants' motion for partial summary judgment on the issue of whether they were liable as current owners of a facility where hazardous substances were released. Those defendants had received shares of stock through family gifts or inheritances, which were later converted to interests in the property when the corporation was dissolved

The court found the circumstances of the transfer was more like a bequest or an inheritance, and thus was subject to the most lenient standard of all appropriate inquiry. Slip. op. at 15-16. Although the defendants did not inspect the property prior to the transfer, the court found that the conduct of the defendants was appropriate. None of the defendants had any knowledge of the existence of PCBs on the property, and none of the defendants had been involved in the operation of the business or property. Therefore, the court concluded, the innocent landowner defense was applicable. The court did not in its opinion that there was evidence that the defendants had holes eaten in their clothes by battery acid while on the property. The cleanup concerned PCBs, however, and the Court stated there was no evidence that the PCB contamination was obvious.

International Clinical Laboratories Inc. was found to have satisfied the requirements of the innocent landowner defense in Int'l Clinical Lab. Inc. v. Stevens, Case NO. CV 87-3472, slip op. (E.D.N.Y. Jan. 11, 1990). The court noted that the selling-landlord had no knowledge of its lessee's hazardous waste activities and that the contamination was not visible to the purchaser's representatives during an inspection. The defense was asserted in this case by the plaintiff-purchaser as against the defendants' arguments that the clean up costs should be apportioned.

The difficulty with the district court decisions is that they do not provide the predictability necessary to carry out financial transactions. Decisions like Int'l

Clinical Labs and Serafini do construe the defenses as the legislative history demonstrates Congress intended. Other decisions, such as BCW and Pacific Hide, are confused and unclear, and to lenders, demonstrate that the innocent landowner defense is too unreliable. Business decisions involving large sums of capital cannot be made on the basis that a court may construe the defense properly. Indeed, given the position of USEPA, lenders cannot properly establish the level of risk in a transaction.

U.S. EPA Position on Innocent Landowner

In a long-awaited guidance document on landowner liability under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), the U.S. Environmental Protection Agency ("USEPA") confirmed that it takes a case-by-case approach to environmental due diligence by an innocent landowner. EPA, "Guidance on Landowner Liability Under Section 107(a)(1) of CERCLA, De Minimis Settlements Under Section 122(g)(1)(B) of CERCLA, and Settlements With Prospective Purchasers of Contaminated Property," at 11 (June 6, 1989) [hereinafter cited as "guidance"]. Rather than set down a checklist or a protocol of required steps, the guidance - a memorandum from USEPA headquarters to its regional offices and attorneys explaining the agency's position - generally cites the suggested inquiries included in the CERCLA.

For lenders, real estate purchasers and others involved in financial transactions the guidance is disappointing. The absence of established standards has had serious effects on financial transactions. The guidance, however, devotes only one short paragraph to lenders. The lender will be potentially liable, the guidance explains, if the lender forecloses and takes title, or if the lender conducts management activities at the facility. The guidance cites United States v. Maryland Bank & Trust Co., 632 F. Supp.

573 (D. Md. 1986) and United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 200992 (E. D. Pa. September 4, 1985). The lender is protected from liability, according to the agency, if the lender made "all appropriate inquiry" prior to acquisition of the facility. There is little "guidance" in the guidance, however, as to what constitutes all appropriate inquiry.

In fact, the guidance makes clear that USEPA's emphasis is on the de minimis settlement provision added to CERCLA by SARA, rather than the innocent landowner defense. In other words, innocent lenders and real estate purchasers will be given an opportunity to settle with the agency prior to or in the early stages of litigation in exchange for access to the site, cooperation in providing information to the agency, and in some instances, a small cash payment. The theme of the agency's guidance, and its approach to the interpretation of the relevant statutory language, is to encourage innocent landowner settlements, and discourage litigation in which landowners prove innocence by evidence. Among the practicing bar, the Section 101(35)(B) defense in SARA is typically termed the innocent landowner or innocent purchaser defense. In the guidance, the agency refers to the defense throughout as the "third party defense." The agency's language arises from its consistent insistence that there are only three defenses to Section 107(a) liability: act of God, act of war, and third party defense. This scheme prevailed during the final days leading to the enactment of SARA, after Rep. Barney Frank had proposed the innocent landowner provision as a fourth defense to CERCLA. Others have written on the legislative process and reasoning for its placement in the statute, but the result was that the innocent landowner defense ended up in the definitions section of CERCLA. See Strock, J., "The Genesis of the 'Innocent landowner' Defense," 3 Toxics L. Rep. (BNA) 592 (1988).

Technically, the guidance is correct; there are only three defenses to Section 107 liability. Practically, the protection afforded to persons who purchased property without knowledge of the presence of hazardous substances is called the innocent landowner defense. Thus, the third party defense which protects property owners because of the definition at Section 101(35) will be called the "innocent landowner defense" throughout the remainder of this article.

Of course, this is the only position which makes sense to the agency. Rather than spend time and money on evidentiary proceedings with landowners, where the agency probably would lose, the agency will obtain what it needs from the landowner (access and information) without undue enforcement resources. The agency's need to settle rather than litigate, however, leads to some interesting positions, such as that Section 101(35) and Section 122(g)(1)(B) are "substantially the same," and some nice legal questions, such as whether the settlement will provide statutory contribution protection from actions by other potentially responsible parties. Essentially, the guidance picks and chooses from the settlement and innocent landowner provisions in order to craft a settlement policy that requires environmental due diligence.

The guidance does create one unexpected problem. In order to enter into a de minimis settlement, the agency will require that a notice of the environmental contamination be recorded in the chain of title for the property, as well as the statement that USEPA makes no representation about the appropriate use of the property. This could interfere with transfer of the property, and it makes settlement much less attractive.

The guidance also addresses settlements with prospective purchasers of contaminated property. Over the last year, the agency has been approached by prospective purchasers of contaminated property. In exchange for a covenant not to sue, these developers will purchase contaminated property, undertake or pay for the necessary response action, and then develop the property at a profit. The guidance makes clear that the agency will entertain a purchase and settlement proposal where there are no other viable responsible parties, and usually only after the remedial investigation/feasibility study ("RI/FS") has been completed.

This section discusses USEPA's guidance in greater detail and addresses the issues raised above. The impact of the guidance on the innocent landowner defense as a tool in financial transactions is discussed first. Next the agency's approach to the defense and settlement provisions, and the associated potential problems is considered. Finally, the discussion turns to the prospective purchaser of contaminated property, and USEPA's requirements for granting a covenant not to sue.

Under the settlement provisions at Section 122(g)(1)(B) the agency will settle with landowners who purchase the contaminated property without "actual or constructive knowledge that the property was used for the generation, transportation, storage, treatment or disposal of hazardous substances." The test of eligibility for a settling landowner is "constructive knowledge." In keeping with its approach of linking the settlement and innocent landowner provisions, USEPA's guidance states that a landowner who demonstrates that he conducted "all appropriate inquiry," which is the standard under the innocent landowner defense, will not be deemed to have "constructive knowledge" under the settlement provision.

According to the guidance, the knowledge test for a settlement is "substantially the same" as for the innocent landowner defense. In other words, in order to qualify as a landowner without constructive knowledge of hazardous substances, the purchaser must have conducted "all appropriate inquiry," which would qualify the purchaser as an innocent landowner. What constitutes "all appropriate inquiry," the guidance states, is to be determined on a case-by-case basis; the determination will be made "on the basis of what is reasonable under all the circumstances."

That approach, of course, is totally unsatisfactory. The source of concern in the financial markets has been the absence of some established standard of due diligence. Lenders and purchasers need certainty in the quantification of risks involved in a transaction. Capital expenditures, wage increases and increases in marketing overhead due to competition are all costs which can be quantified. But million dollar expenditures due to historical contamination cannot be factored into the transaction. Particularly in view of the typical debt-heavy capital structure of many of the acquisitions done today, deals will go into the tank if limitless environmental problems arise.

Lenders do transactions because they want to be repaid according to the terms of the deal. Although the collateral is a backstop, there is no point in lending money if it is likely that there will have to be a workout or foreclosure on the collateral. Even before a lender reaches the issue of coverage of the debt by the collateral, the first concern is the borrower's ability to repay according to the terms of the loan. After the lender is satisfied, or at least comfortable, with repayment, the next concern is the lender's ability to recover the original outlay through the proceeds from the sale of the collateral. Then the issue is whether the collateral has sufficient value and marketability to allow the lender to turn it over quickly at a reasonable price. Setting aside the issue of lender liability because of foreclosure, which is the worst case scenario, the collateral will be valueless if a major environmental problem is discussed.

In response to these environmental concerns, the typical practice in purchase and lending transactions is to order up a "Phase I" audit of the subject property. The difficulty is that no one is really sure what a "Phase I" audit really should include. Is sampling always necessary? Whether "punching holes" is always part of "all appropriate inquiry" has been, and continues to be, the most troublesome issue in environmental due diligence.

Once a potential purchaser decides to sample, a variety of other questions come up: How many holes? Where? What should the samples be analyzed for? Similarly, how far back should chain of title be investigated? Is 30, 40 or 60 years enough? Should the auditor always interview next door neighbors? If so, inevitably the development plans will be leaked. If that information is already public, then at the least the adjacent landowners will get stirred up.

Almost every part of a standard protocol or methodology faces these same kinds of questions. Is this inquiry going to cost more than its worth, in terms of money and controversy, or is it necessary for environmental due diligence? Once it is complete, is it enough?

The difficulty with a private industry response is that the issue of the sufficiency of a Phase I protocol, meaning a report which demonstrates "all appropriate inquiry," is left to the agency's discretion whether to settle with this particular landowner. That determination is made on case-by-case basis without clearly established guidelines. Presumably, USEPA knows an innocent landowner when it sees one, but if the government is not satisfied, the final test is a determination by a reviewing court. The problems associated with overworked and undersophisticated courts making important policy decisions which impact upon literally trillions of dollars worth of transactions do not need to be spelled out. Through this case-by-case approach the agency abrogates its responsibility to interpret the law and ignores an opportunity to establish important policy within the framework of the statute.

What is surprising about the agency's failure to act is that this is one instance in which the agency's goals are the same as the potentially responsible party.

Just like USEPA, lenders and purchasers want clean property. Lenders also understand that environmental risk is a credit matter, as well as a factor in the value of the collateral. The borrower must have a program in place to minimize the risk of a big environmental hit. The playing field has to be level, however. If everyone was required to perform the same level of due diligence, then loan officers would not be shy about including that as a condition of closing. Moreover, if there was protection, lenders would be willing to invest in environmentally risky businesses. The point is that USEPA has an opportunity to establish a policy which promotes its goals while facilitating transactions. The absence of sufficient guidance forces lenders and purchasers to reallocate the risk through documentation, rather than, in many instances, investigating the nature of the property.

In addition, the absence of established standards has upset environmentally risky transactions. Lenders are much less willing to do deals on collateral which the engineer can only say "may or may not" have a problem. For example, assume a borrower proposes to renovate an old steel mill to produce specialty steel products, and wants to use the facility as collateral. How extensively should the property be investigated? Will the lender have enough comfort, no matter how thorough the review, to finance the acquisition, if the best counsel can say is that the agency may settle landowner liability issues for past contamination? Presumably, it is a socially and economically attractive transaction because a rusted plant would be put back in service. The environmental risks might prevent the borrower from finding financing.

The deal would be much more difficult to do if it could not support the cost of extensive environmental due diligence. Commercial transactions in the $1 million to $5 million range are the bread and butter of many local institutions. Those deals finance small businesses. It is becoming increasingly difficult to do transactions of that size where there is an appreciable environmental risk. In the steel mill example, it is impractical if the deal was of that size to require the borrower to do all the work which would be necessary for the lender to be comfortable on a "case-by-case" basis.

An even more difficult question, under the agency's case-by-case approach, is what are the risks once some problem has been discovered. For example, assume soil sampling shows 100 parts per million of light petroleum contamination. Is that a problem which should upset the transaction? Is further testing necessary? Should the lender require that the contaminated soils be removed and disposed of offsite? That is usually prohibitively expensive and not necessary even in a cleanup.

In order to be sure of no lingering environmental liability, however, excavating the soils is a prudent and cautious measure. Can any institution do a transaction on contaminated property where the lender's take out is to look to the collateral?

By default, the policy the agency is implementing is to cause the market to leave idle environmentally risky properties, and to make it more difficult for small business manufacturing operations to obtain capital. This scorched earth approach will turn potentially productive real estate parcels into tracts of vacant land. Old plants will get rustier because no financing is available to renovate the property. Similarly, small manufacturers will find it increasingly difficult to obtain funds, other than as divisions or subsidiaries of large operations. Regardless of whether this is appropriate, the point is that this is not the result of policymaking, but of inaction.

Lenders and purchasers are walking away from environmentally risky deals because of the uncertainty. Although no surveys or questionnaires have been published, many transactional attorneys have anedoctal evidence of deals killed by environmental questions. It seems foolish that otherwise economic and socially productive deals should be lost because USEPA refuses to provide certainty through established guidelines.

The guidance does point out that the agency will require a more comprehensive inquiry for those involved in commercial transactions, than for those involved in residential real estate transactions. The guidance suggests "a survey for contamination may be recommended" in commercial transactions, while that kind of inquiry may not be necessary by the purchaser of personal residential property.

The guidance also notes that the burden of inquiry will increase "concomitantly as the public awareness of environmental hazards increase." Since the duty to inquire will be judged as of the time of the acquisition of the property, whether all appropriate inquiry was undertaken becomes an historical and forensic enterprise.

After setting down a case-by-case approach to the landowner defense, the guidance does go on to identify information which should be provided by a landowner proposing a de minimis settlement. Since the "constructive knowledge" test for a de minimis settlement is based upon "all appropriate inquiry," conversely, information with which a landowner must come forward to settle, should also constitute all appropriate inquiry under the innocent landowner defense. Early in the guidance, however, USEPA points out that the "quality and quantum of evidence" demonstrating the landowner's eligibility for a de minimis settlement may differ from that necessary to establish the innocent landowner defense at trial.

The implication, presumably, is that a landowner many not have "constructive knowledge" of hazardous substances, but still did not accomplish all "appropriate inquiry" for the innocent landowner defense. The agency's position thus contradicts the first premise, set forth one page earlier, that the requirements of the settlement provisions are "substantially the same" as the elements necessary to establish the innocent landowner defense. The reason, of course, is to encourage the landowner to settle rather than fight. The difficulty is that the parameters of all appropriate inquiry are made less clear, and the contribution protection in a settlement could be weakened.

The guidance does set forth the information which the landowner should submit along with a proposal for the settlement. The requested information sort of establishes a basic phase I audit, because a transaction participant could, at the least, offer to settle liability to the agency based on this information.

The landowner must provide:

(a) All evidence relevant to the actual or constructive knowledge of the landowner at the time of acquisition;

(b) All affirmative steps taken by the landowner to determine the previous ownership and uses of the property;

(c) Information regarding the condition of the property at the time of purchase;

(d) All documentation and evidence of representations made at the time of sale regarding prior uses of the property;

(e) The purchase price of the property and the fair market value of comparable property at the time of acquisition; and

(f) Information regarding any specialized knowledge on the part of the landowner which may be relevant.

Some of these requirements are straight from Section 101(35), but others reflect some accommodation to environmental due diligence practice today. For example, as noted above it is typical to obtain a phase I audit regarding the condition of the property. In addition, it is typical to obtain representations and warranties from the seller or borrower concerning prior uses of the property, and in the case of a loan transaction, the future uses of the property. Also, many times appraisals of the collateral are prepared which use comparables in order to establish fair market value. Again, however, the real issue is what information is necessary regarding the condition of the property at the time of purchase, which is an issue the guidance does not address.

In addition to providing information concerning actual or constructive knowledge, a settling landowner must provide information concerning whether he exercised due care and whether he contributed to the release through any act or omission. Like the constructive knowledge standard, this requirement is a hybird of Section 101(35) and Section 122(g). Nothing in the settlement provision requires the landowner to exercise due care at the time the contamination is discovered, although the agency could argue that without due care, the landowner did contribute to the release of contaminants.

To establish due cause, the landowner should provide information about:

(a) The circumstances under which the hazardous substances were discovered;

(b) The extent of the landowner's knowledge regarding the substances;

(c) All measures taken by the landowner to abate the threat of harm to human health and the environment posed by such substances; and

(d) All measures taken by the landowner to prevent foreseeable acts of third parties which may have contributed to the release.

All of the above information must be included in the settlement document, and the agreement is contingent on its accuracy.

As noted above, the agency's approach is to read together the de minimis settlement and the innocent landowner provisions. The language of each is different, however, and that approach leads to somewhat strained interpretations. For example, "constructive knowledge" for a de minimis settlement is construed with regard to "all appropriate inquiry" under the innocent landowner provision. The guidance document also reads into the de minimis settlement provision the requirement that the landowner have exercised due care with regard to the contamination and have taken steps to prevent foreseeable acts of third parties.

In addition, as written and enacted, a de minimis settlement is probably unavailable to every potentially responsible landowner, because it is unavailable where a landowner has generated, transported, stored, treated or disposed of "any hazardous substance at the facility." The guidance states that USEPA interprets the phrase "any hazardous substance" to mean the hazardous substance which is the subject of the release. Otherwise, any landowner who utilized typical household chemicals would be ineligible for settlement. Only by this admittedly strained reading is the agency able to interpret the de minimis settlement provision like the innocent landowner defense. The innocent landowner defense specifically provides that an eligible defendant have no reason to know of any hazardous substance "which is the subject of the release."

The guidance also recognizes that the term de minimis settlement is probably a misnomer. Generators and transporters of hazardous substances who are eligible for de minimis settlements under Section 122(g)(1)(A) have no defense from liability for response costs. Settling landowners, to be entitled to take advantage of the settlement provisions of Section 122(g)(1)(B), must be innocent and thus do have a defense to liability. Settling landowners are de minimis only in the sense that the consideration for the settlement is de minimis; it has nothing to do with contribution to the contamination.

The concern with the agency's interpretation of the de minimis settlement provision is whether it will be effective as against a claim for contribution by other PRPs. Under Section 113(f)(2) and Section 122(g)(5) the settling defendant is supposed to receive protection against contribution actions by other potentially responsible parties. The agency's authority to enter into the settlement arises from the statutory language, with which, arguably, there has not been compliance. Thus there is some question whether a private party can attack the settlement because the agency acted outside the authority established in the statute.

In order to obtain a de minimis settlement, a landowner must provide access to the property, cooperation in the agency's response activities, and in some instances, a cash payment. The guidance document appears to establish three levels or kinds of settling with landowners. First, there is a landowner who can make a "thoroughly convincing demonstration" and persuade the government that there is a "very high probability" that the innocent landowner defense can be established. For that first level settlor, the agency will require only that the landowner provide access to the property and due care assurances during the course of the response action. Second, there is a landowner who cannot make a "thorough and convincing demonstration," but is still able to persuade the agency that it is "likely" that the innocent landowner defense can be established. That second level landowner can settle for cash consideration, as well as access and due care assurances. Third, there is a landowner who cannot demonstrate eligibility for a de minimis landowner settlement, but who may be eligible for a Section 122(g)(1)(A) settlement using the same criteria as any other PRP under CERCLA. See "Interim CERCLA Settlement Policy," 50 Fed. Reg. 5034 (February 5, 1985); "Interim Guidance on Covenants Not to Sue Under SARA," 52 Fed. Reg. 28038 (July 27, 1987). This third category of garden variety Section 122 settlement depends upon the amount and toxicity of the hazardous substances contributed by the settlor to the facility.

Thus, under the guidance document there are three categories of settlors: (a) very high probability innocent landowners, (b) likely innocent landowners, and (c) liable landowners, but not very liable. Depending upon where the landowner falls on this scale, the agency will increase the consideration extracted for the settlement. Very high probability innocent landowners can escape without a cash payment, while likely innocent and liable landowners will have to pay some money. Nowhere in the guidance, however, is there any discussion of a range, or even any suggested guidelines, for the amount of the cash payment.

In addition to any cash payment, as consideration for any settlement, the guidance states the agency will require the landowner to provide access to the property and to cooperate in the agency's response activities. The model consent decree and administrative order on consent included as attachments to the guidance, provide that the settlor recognizes that the agency's response actions may interfere with the use of the property.

The model settlements also require that the landowner continue to "exercise due care with respect to the hazardous substances at the site." The nature of this "due care" responsibility is not set out, nor is it established in the model settlement documents.

Presumably, the due care required by the settlement is not like the due care requirement in Section 107(b)(3). That section requires the landowner to take steps necessary to protect the public from a health or environmental threat. If the agency is already undertaking a response action at the site, and it is preventing the landowner from interfering in its actions, it is inconsistent to require the landowner to take affirmative due care steps. In a footnote to that requirement, however, the guidance sets out the Conference Committee statement on due care which requires "those steps necessary to protect the public from a health or environmental threat."

Whether a landowner is willing to enter into a settlement conditioned upon an undefined and inappropriate requirement to do more than the agency is already doing to protect public health at the property is unclear. Again, that kind of provision weakens the settlement agreement and could impact upon the protection afforded the landowner against contribution suits.

Finally, the guidance requires the landowner to file in the local land records a notice, acceptable to USEPA, stating that hazardous substances were disposed of the site and that EPA makes no representations as to the appropriate use of the property. Notice in the chain of title about the response action will make the property more difficult to convey.

Particularly if the contamination was not extensive, and the property has gone through remediation similar to clean closure, probably it is not necessary to require the notice. If the site is on the National Priorities List, it may be appropriate to record notice of the response action, but to require notice in all instances may make settlement difficult. In addition, the guidance does not include a form for the notice, and it is not clear what must be included in order to be "acceptable" to USEPA.

For innocent landowners, the bottom line of the USEPA guidance is that the agency will entertain a de minimis settlement proposal under the authority set forth in Section 122(g)(1)(B) based upon the requirements set forth in Section 101(35) that all appropriate inquiry had been made prior to the acquisition. By settling, the landowner can resolve its liability early in the proceeding, avoid the associated transaction costs, while obtaining legal repose as to its liability to all PRPs. Similarly, the government is able to resolve the liability of the landowner without spending scarce enforcement resources.

By making the due diligence test a factual issue, however, the agency necessarily establishes a resource intensive scheme for resolving innocent landowner liability. Contested cases will involve expert witnesses, evidentiary hearings and extensive briefing and argument. For example, in United States v. Louis Serafini, et al., No. 86-1591, slip op. (M.D. Pa. Feb. 19, 1988), the government twice attempted to obtain summary judgment against the Serafini brothers.

This kind of extended proceeding involving evidentiary hearings and expert witnesses is exactly what the agency is attempting to avoid through the settlement provision. Although Serafini is somewhat of a special case, generally, the agency will seek to avoid resource intensive methods of settling liability, where settlement is appropriate. In the guidance, USEPA pointed out that it does not agree with the Serafini decision because the criteria set forth in Section 101(35)(b) seemed to contemplate, at a minimum, a visual inspection. The agency did agree with the Serafini court that the "all appropriate inquiry" standard has an evolutionary aspect which the agency sees developing into higher standards of a duty to inquire.

The problematic impact of the uncertain nature of environmental due diligence has not been resolved by USEPA's guidance. What constitutes "all appropriate inquiry" remains a question without an authoritative answer. Innocent landowners probably feel better that the agency might settle CERCLA liability, but there is still no certainty. If the agency does not want to settle, and it is within its discretion not to do so, then the landowner is uncertain of its liability. It is the uncertainty which made this an issue in the first instance, and the uncertainty remains even after the guidance was issued.

Thus it is plain that EPA has interpreted the innocent landowner defense in a way which is inopposite to Congressional intent when enacting SARA. First, lenders are told that there is no such thing as an innocent landowner because the all appropriate inquiry standard can never be satisfied. Then second, lenders are told that EPA will only settle with lenders when it believes it appropriate and for some consideration. That two pronged interpretation has created the uncertainty which brings me before this Committee today.

Effect of Fleet Factors on Secured Lending

The hearing on this legislation is particularly timely in view of the recent decision on ownership lender liability. In United States v. Fleet Factors Corp., case No. 89-8094, slip op. (11th Cir. May 23, 1990), the court broadened the reach of Superfund to a secured lender who participates in the financial management of the borrower's business. The opinion makes clear that a secured lender can be liable as an owner, even absent foreclosure, when the lender participates in the financial management of the borrower's facility. In focusing on the degree of financial management as a source of lender liability, the decision suggests a significantly lower threshold for liability than the day-to-day control required of operator liability.

Until the Fleet Factors decision, as noted above a secured lender who did not foreclose and did not participate in operational decisions had been exempt from liability under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), commonly known as "Superfund." The lower courts have distinguished financial management, such as accounts receivable management, from operational management, such as product recommendations, in deciding whether a lender was a facility "operator." Secured lenders thus could avoid Superfund liability by not foreclosing on contaminated collateral and not becoming entangled in day-to-day production decisions.

The Fleet Factors court established an expanded theory of secured lender liability for the borrower's environmental problems. In addition to lender liability as an operator, a lender can be liable as an owner where the lender has a security interest in the facility and participates in financial management. The difference between operator liability and owner liability, in the court's view, is the degree of involvement. The secured lender can be liable if the court can infer that the secured lender could have affected hazardous waste decisions if it wanted to do so. In other words, under the Fleet Factors test, a secured lender will be liable if the court finds it could exert sufficient influence over the borrower's decisions.

In Fleet Factors, the lender held a security interest in the equipment, inventory and fixtures of a bankrupt company. As additional collateral, the lender held a security interest in the debtor's facility evidenced by a deed to secure the debt that conveyed titled to the real property. Although the lender realized on its security interest in the inventory and equipment, it never foreclosed on the real property. In 1982, the borrower ceased operation, and some of its inventory and equipment was sold at an auction. Later, the lender entered into a contract with a third party to remove the unsold inventory and equipment from the plant.

In 1984, the U.S. Environmental Protection Agency inspected the facility and initiated a response action when it found hazardous waste. The facility was conveyed to the county in 1987 at a tax foreclosure sale which resulted from the debtor's failure to pay state and county taxes. U.S. EPA later filed an action to recover costs incurred from the cleanup of the facility. The district court held as a matter of law that the lender neither owned nor operated the facility immediately before the tax foreclosure for the purposes of liability under Superfund. Fleet Factors was not liable as a current owner or operator for contamination on the property occurring prior to the cessation of operations. United States v. Fleet Factors Corp., 724 F.Supp. 955 (S.D. Ga. 1988).

The district court refused to grant summary judgment completely dismissing Fleet Factors from the case. The government argued that after the borrower ceased operations and entered bankruptcy, the lender's agents liquidated the remaining inventory and sold the equipment and machinery. During the course of this work, the government claimed, asbestos was knocked loose from piping and the auctioneer moved barrels which contained hazardous substances. The resulting condition of the property caused the government to incur response costs. The court found that the facts were disputed, and held that the issue would be addressed at trial. Fleet Factors and the government both took an interlocutory appeal of the trial court's decision.

While affirming the trial court's denial of the lender's motion for summary judgment, the appellate court significantly expanded the scope of Superfund liability for lenders. The court first agreed that lenders who participate in day-to-day operational management of a facility will be liable as "operators" under the liability provision of CERCLA. That was the theory utilized in United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994 (E.D. Pa. 1986). The Mirabile court distinguished between permissible participation in the financial management of the facility and impermissible participation in the day-to-day or operational management of the facility. The district court in Fleet Factors had adopted the distinction set forth in Mirabile, and found that the lender would not be liable as an operator of the borrower's facility.

The appellate court explicitly rejected the Mirabile distinction, and disagreed with the trial court's finding that the lender was not liable for contamination during the winding down period. The court noted that the government had alleged facts which if proven, would be sufficient to impose CERCLA liability on Fleet Factors as an operator. Slip op. at 24. Rather than analyze the case under the "operator" liability theory, however, the appellate court approached the issue through a secured creditor analysis. The court found that the lender could be liable as an "owner" of the facility, because it lost its security interest statutory exemption through financial management of the borrower.

The Fleet Factors court noted that CERCLA imposes liability on "any person who at the time of disposal of any hazardous substance owned or operated" the facility where the hazardous substances were disposed. 42 U.S.C. §9607(a)(2). CERCLA excludes from the definition of "owner or operator" any "person, who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility." 42 U.S.C. §9601(20)(A). Fleet Factors did hold "indicia of ownership" in the facility through its deed of trust to the real property, and that interest was held primarily to protect its security interest in the facility. The critical issue for the court was whether the lender "participated in management" sufficient to lose its security interest exemption. If so, then Fleet Factors could be liable as an owner of the facility, in addition to its potential operator liability.

The court then reviewed the difference between the phrase "participating in the management" and the term "operator." Since lenders were already liable as operators when exercising day-to-day control, the language of the security interest exemption must mean something different. In the court's view, Congress explicitly intended to hold secured creditors liable if they participate in the management of the facility. The Mirabile test for participation, used by the district court, was "too permissive" toward secured creditors. Slip op. at 17. Instead, the appellate court articulated its own test for "participating in the management" of the facility to such an extent as to lose the security interest exemption protection under the statute:

> [A] secured creditor may incur [owner] liability, without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous waste. It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable--although such conduct will certainly lead to the loss of the protection of the statutory exemption. Nor is it necessary for the secured creditor to participate

> in management decisions relating to hazardous waste. Rather, a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose.

Slip op. at 18-19 (emphasis supplied). In a footnote, the court noted that the lender's capacity to influence a debtor facility's treatment of hazardous waste will be inferred from the extent of its involvement in the facility's financial management. Slip op. at 24. Under the court's interpretation, there is no need to show that the lender actually did affect hazardous waste decisions.

Utilizing this new standard, the appellate court first found that prior to the time the borrower ceased operations, the lender had not taken steps which would cause it to lose its protection:

> From 1978 until [the borrower] ceased printing operations on February 21, 1981, [the lender's] involvement with the facility was within the parameters of the secured creditor exemption to liability. During this period, [the lender] regularly advanced funds to [the borrower] against the assignment of [the borrower's] accounts receivable, paid and arranged for security deposits for [the borrower's] Georgia utility services, and informed [the borrower] that it would not advance any more money when it determined that its advanced sums exceeded the value of [the borrower's] accounts receivable.

Slip op. at 23-24. After the borrower stopped its operations, the lender's level of involvement increased:

> [The lender] required [the borrower] to seek its approval before shipping its goods to customers, established the price for excess inventory, dictated when and to whom the finished goods should be shipped, determined when employees should be laid off, supervised the activity of the office administrator at the site, received and processed [the borrower's] employment and tax forms, controlled access to the facility,

> and contracted with [the liquidator] to dispose of the fixtures and equipment at [the facility].

Slip op. at 24. These additional steps were sufficient to impose owner liability on the secured lender.

In its discussion of the new, lower threshold of liability, the Fleet Factors court attempted to articulate a private policeman policy for its holding. According to the court, the lending community's awareness of potential CERCLA liability will encourage lenders to monitor hazardous waste treatment systems and policies of their debtors. Lenders will insist upon compliance with acceptable treatment standards as a prerequisite to continued and future financial support. Lenders will have a strong incentive to address hazardous waste problems at a facility, rather than studiously avoid the investigation and remediation of the problem. Slip op. at 21-22. In support, the court cited a number of student-written law review articles that suggested it is good public policy to hold lenders liable for the environmental problems of borrowers.

The language of the court's test, if applied literally, suggests a low threshold for liability. The facts recited by the court, however, arguably demonstrate the kind of day-to-day control associated with operator liability. If other courts later apply the Fleet Factors decision with close regard for its facts, then its reach of liability may not be much broader than the Mirabile decision. The Fleet Factors court, however, plainly intends that its holding go beyond the boundaries of prior decisions. In effect, the court has established a third category of owner or operator liability. Earlier courts recognized that lenders who foreclosed on property were owners, and that lenders who operated property were operators. Now, lenders who have a security interest in property, plus the capacity to exert financial management, are enough like owners to be liable. The result of the Fleet Factors decision is that in construing the secured lender's statutory protection from liability, the court has added secured lenders as a new class of potentially liable parties.

In stepping so far beyond the holdings of other courts, Fleet Factors has fallen out of the mainstream of the law. Other courts could distinguish the decision on the basis of its facts, and refuse to follow the holding. Indeed, the case is binding authority only in the eleventh circuit, which consists of the federal courts in Alabama, Georgia and Florida. Practical circumstances also could affect the strength of the holding. Fleet Factors was decided by a quorum of the appellate court panel. During the pendency of the case, one of the regular circuit judges passed away and did not participate in the decision. Of the remaining two, one of the judges was a senior U.S. district judge sitting by designation. Thus, of the three judge panel which heard oral argument, only one judge on the holding was a regular circuit judge.

Until other courts construe the Fleet Factors decision, the impact upon secured lending transactions could be of concern. Although the court exempted creditors involved in occasional and discrete decisions which relate to protection of a security interest, it is unclear how far a lender can go in enforcing its rights. At this point, the Fleet Factors decision probably will affect new transactions in six ways, and may affect workouts of defaults.

First, the decision probably will increase the level of environmental due diligence now undertaken in secured transactions. Clearly, the best way to avoid a Fleet Factors problem is to identify the environmental issue before closing the transaction. In that manner, unacceptable risks can be dealt with through other transaction mechanisms. In addition, there will probably be a greater scrutiny of the borrower's business operations on the collateral prior to closing. Since many of the problems in Fleet Factors occurred after closing, it will not be enough to review the past history of the collateral. Rather, secured lenders will be concerned about the nature of the borrower's business and the potential for contamination on the collateral during the term of the financing.

Second, lenders will not take a security interest in a facility which is known to be contaminated. Since one of the elements of the Fleet Factors test is whether the lender held indicia of ownership, it may be enough to refuse a lien on affected property. That approach would be consistent with the Fleet Factors underlying theme, which is to encourage cleanups through market forces. Borrowers who cannot obtain financing on contaminated collateral will undertake the remedial steps necessary to address environmental problems.

Third, to the extent that environmental problems are discovered during the due diligence investigation, those items probably will need to be addressed prior to closing. In the past, many environmental issues had been handled as post-closing items through side agreements or additional covenants. Generally, secured lenders felt comfortable once the nature and extent of the problem had been determined, and the cost had been accurately assessed. Provision was usually made for funding the environmental remediation, and typically the work was completed to the lender's satisfaction. Now, that kind of review after the closing could jeopardize the secured creditor exemption.

Fourth, secured lenders will carefully review the covenants included in the financing documents. If Fleet Factors is read literally, the capacity to affect company decisions along with some exercise of control could cause the loss of the secured creditor exemption. Covenants requiring cleanup of spills or releases may need to be reviewed, particularly where the lender is influencing financial aspects of the borrower's business. Certainly once the transaction has been closed, secured lenders will look very carefully at enforcing covenants, whether financial or otherwise. Although "discrete" steps may be safe, lengthy negotiations and enforcement steps designed to bring a borrower into compliance with the loan documents could be troublesome.

Fifth, secured lenders may require additional indemnities and personal guarantees from principals and parent corporations, if such appears in the best interest of the lender after analyzing any competing legal risks. Lenders will require an additional source of funds where enforcement of contract rights against the borrower could cause liability. Nonrecourse transactions, in particular, could be impacted by Fleet Factors, since any steps to realize on the collateral, even through collecting the property rents, could affect the secured creditor exemption.

Sixth, smaller transactions, such as working capital financing or other credit facilities, could suffer a greater impact from Fleet Factors. Lenders who refuse to advance additional funds because of the borrower's environmental problems may run the risk of secured creditor liability. The policy language used by the Fleet Factors court suggests a commitment by the secured lender to monitor and help with the borrower's environmental issues. Yet, if the borrower has an environmental problem, and the lender takes steps beyond monitoring the financial position, there could be a risk of liability.

Fleet Factors also could affect workouts of troubled borrowers. Lenders will need experienced and competent counsel, familiar with the parameters of Fleet Factors, when dealing with the issues presented by a default situation.

In summary, the Fleet Factors appellate court envisions lenders as environmental police, who will cause their borrowers to comply with environmental laws through market forces. In order to encourage lenders to closely monitor borrowers, the court has provided the government with an expanded theory of lender liability. Although lenders will undertake more extensive due diligence, environmentally active borrowers may find it more difficult to obtain capital.

Conclusion and Statement of Support

Although my prepared statement is lengthy, I hope I have set out the legal framework for the legislation before you today. The patchwork of conflicting and confused court decisions do not provide the predictability or certainty necessary to make lending decisions. Courts that have remained true to Congressional intent have provided some protection. Courts like Fleet Factors, however, have raised the alarm to almost a fever pitch among the lending community. In addition, EPA's twisted interpretation of the CERCLA provisions has emptied the law of any protection otherwise afforded, and its guidance has made clear and certain that lenders must make decisions based upon unclarity and uncertainty.

The effect on the ability of small businesses to obtain financing is tremendous. In response to the uncertain risks, lenders are demanding prohibitively expensive environmental due diligence - a new industry created out of the issues we have discussed. Of course, that is assuming the small business is able to obtain a commitment in the first place.

Many of the risks associated with CERCLA are the kinds of risks already evaluated by lenders: the borrower's inability to repay the loan, the value of collateral and the impact of borrower's activities on the collateral. The real danger, however, is the uncertainty associated with foreclosing on the property and assuming the risk of cleanup liability.

This legislation will address that uncertainty and that risk, and will provide the certainty which secured lenders need to lend to small businesses.

I support the passage of the legislation before the Committee today.

AAEL
American Association
of Equipment Lessors

June 26, 1990

HAND DELIVERED

Honorable John J. LaFalce
Chairman, House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

Re: H.R.4494

Dear Chairman LaFalce:

I'm writing to you on behalf of the American Association of Equipment Lessors (AAEL). We strongly support legislation designed to ensure the continued flow of investment capital to small business and other projects, by clearly marking the limits of potential liability for financing sources under the "Superfund" statute. *See* Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or "Superfund"), 42 U.S.C. §9601 *et seq*., as amended.

Your bill already insulates bank leasing companies from Superfund liability. Yet non-bank related leasing companies provide about 70% of all lease financing in this country, far more than the 30% provided by bank leasing companies. The objectives of H.R. 4494, as well as basic fairness, would be better served if all leasing companies were given the same scope of Superfund immunity when they engage in identical lease financing activity. Outlined below are (1) the important role that equipment leasing plays in assisting small business and capital formation in this country, (2) a description of the uncertainties that now exist about a finance lessor's potential liability under the Superfund statute, and (3) a suggestion for clarifying legislative language to be added to H.R. 4494 to address the problem.

BACKGROUND

1. Equipment leasing in America. Today the equipment leasing industry accounts for well over 30% of all capital investment in the United States each year, placing over $130 billion worth of equipment in service annually in the United States. Second only to the commercial paper/bond market, leasing is the second largest source of investment capital for business, industry and agriculture in our Nation's economy. AAEL is the major national trade association in this multi-billion dollar industry, with approximately one thousand member

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companies engaged in every conceivable aspect of equipment leasing.

Types of equipment leased include computers, office equipment, manufacturing and industrial equipment, as well as transportation equipment. Facilities leasing is also becoming more common today, with tax incentives encouraging lessors to provide the financing and investment capital needed to build special types of facilities -- such as wastewater treatment plants, and facilities that generate electricity from used tires-- that are operated by others for essentially public purposes.

Our industry historically has played a particularly important role in providing needed capital equipment to start-up companies and small businesses that may lack the financial resources to purchase needed equipment. Yet it is safe to say that equipment leasing is now utilized, at least in part, by virtually every segment of our National economy. Equipment leasing provides a major alternative for American businesses to obtain needed capital equipment, without obtaining a loan.

2. Superfund's uncertain impact on secured lenders and lessors. The impact of the Superfund statute on lenders and lessors is making it difficult or impossible for many small businesses and other projects to obtain needed financing.

One source of difficulty is that the Superfund statute is not as clear as it might be in exempting from liability wholly passive finance lessors of equipment, who supply only money to the transaction and who do not participate in managing, operating or repairing the leased equipment. The statutory history suggests that such passive finance lessors should be immune from Superfund liability under the "secured lender" exemption from "owner or operator" liability in 42 U.S.C.§9601-(20)(A).[1] But the statutory language does not clearly reflect this history. This is unfortunate, since lenders and finance lessors provide essentially similar financing services; they are competing methods of financing; and they should be treated equally under the Superfund statute.

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[1] See H.R.Rept.96-172, Part 1, 96th Cong., 1st Sess. at 36 (1979) reprinted in 5 1980 U.S.Code, Cong.& Admin. News 6181 ("owner" does "not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a vessel or facility, hold title either in order to secure a loan or in connection with a lease financing arrangement under the appropriate banking laws, rules, or regulations.").

The other "chilling effect" on financing stems from recent court decisions interpreting the Superfund statute to mean that a secured lender or lessor that forecloses on a facility that turns out to be contaminated with hazardous waste can be held liable for the entire cost of the cleanup plus damages, even if the lender or lessor in no way contributed to the hazardous waste problem at the facility.[2] See, e.g., Guidice v. BFG Electroplating and Mfg.Co., ___ F.Supp.___, 1989 WL 197105 (W.D.Pa. Sept. 1, 1989). See also United States v. Fleet Factors Corp., ___ F.2d ___ (11th Cir., May 23, 1990), 58 U.S.L.W. 1190, 2713 (June 12, 1990). The so-called "innocent landowner" defense to Superfund liability applies only to real estate (not personal property), and it requires an expensive environmental assessment before it can be invoked. See 42 U.S.C. §9601(35)(A)-(B), §9607(b)(3). The cost of an environmental assessment, which can range from $2,000 to well over $100,000, raises the cost of financing to effectively foreclose financing for many small businesses and other projects.

Toxic waste cleanups often cost millions of dollars, which may be more than the value of the financing or the property itself, and CERCLA contains no limit on the amount of liability. Traditionally, lenders and finance lessors are not in a position to monitor the activities of the businesses which they finance, since they play no role in the management or operation of these businesses. Moreover, if lenders and finance lessors were to try to increase their participation in management, they might well expose themselves to potential Superfund liability as "operators" of the financed business. See United States v. Fleet Factors Corp., supra, (11th Cir., May 23, 1990). Faced with this dilemma, many lenders and finance lessors have stopped extending financing to businesses where there is even the smallest risk of hazardous waste contamination. Other lenders and finance lessors have continued to extend financing, but at a premium price that reflects the risks and uncertainties of Superfund liability.

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[2] There have been no cases discussing the potential Superfund liability of equipment lessors. But equipment lessors are particularly concerned about the possible impact of Superfund on them in two situations: (1) where the lessor is a passive finance lessor of transportation equipment such as aircraft, motor vehicles, or railroad rolling stock (all of which are Superfund "facilities") from which there is a spill of toxic chemicals; and (2) where the lessor is a passive finance lessor of a facility (a wastewater treatment plant, or electric generating plant, for example) that is possessed and operated by others.

FINANCE LESSOR'S AMENDMENT TO H.R. 4494

Your bill, H.R.4494, addresses these problems by protecting secured lenders, bank leasing companies, and several other similarly situated financing institutions (including public lenders) from Superfund liability when they merely foreclose on property that turns out to be contaminated. H.R. 4494 complements the "secured lender" exception from Superfund "owner or operator" liability (see 42 U.S.C. §9601(20)(A)) by immunizing financing sources after foreclosure, just as the "secured lender" exception immunizes financing sources before foreclosure. This is entirely appropriate. These institutions are sources of financing; they do not cause or contribute to the release of hazardous substances into the environment. Imposing Superfund liability on them would only undercut capital formation and the flow of capital for many environmentally beneficial projects.

Our submission is that finance lessors, whether bank affiliated or not, should be shielded from inappropriate Superfund liability. Traditional tort law principles have long immunized finance lessors from strict tort liability because of their lack of involvement with the leased equipment. See Fraser, Application of Strict Tort Liability to the Leasing industry: A Closer Look, 34 Bus.Law. 605 (1979); see also Uniform Commercial Code §2A-407; §2A-103(1)(g). As Congress recently recognized in the Price-Anderson Act, there is no sound policy reason to impose "ownership" liability on finance lessors who do not possess or control a leased facility. See 42 U.S.C. §2210r, 102 Stat.1078. Today finance leasing plays a vital role in our Nation's economy. To safeguard this important source of investment, and to keep a "level playing field" for the choice between different kinds of financing (secured lending vs. leasing) to acquire capital equipment, the same scope of Superfund immunity should be extended to companies engaged in lease financing, on the one hand, as is extended to companies engaged in secured lending, on the other hand.

To be specific, we propose that the following new subsection be added to page 3 of H.R. 4494, modifying 42 U.S.C. §9601(20)(D) to make it clear that the term "owner or operator" under Superfund does not include

> (v) Any designated lessor which acquires ownership, possession or control of a vessel or facility pursuant to the terms of a lease financing arrangement or sale-leaseback financing arrangement or security interest involving the vessel or facility.

To define the term "designated lessor", we propose that the following new section be added to page 5 of H.R. 4494:

(4) DEFINITION OF DESIGNATED LESSOR.-- Section 101 of the Comprehensive Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601) is amended by adding at the end the following new paragraph:

(40) DESIGNATED LESSOR.-- The term "designated lessor" means any person who, without participating in the management of a vessel or facility, holds an ownership interest, or beneficial ownership interest, in the vessel or facility and participates as a lessor, or as an equity participant or investor in such lessor, in a sale-leaseback financing arrangement or other lease financing arrangement involving the vessel or facility.

The impact of the amendment we propose would simply put all finance lessors on an equal footing with secured lenders, insofar as Superfund liability is concerned.

Thank you for considering AAEL's views on this important issue. Our industry is concerned about the "chilling effect" that the Superfund statute is now having on lease financing projects. We look forward to your earliest favorable response.

Yours very truly,

Michael J. Fleming

Michael J. Fleming
President, AAEL

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June 27, 1990

BY HAND

The Honorable John J. LaFalce
Chairman
Committee on Small Business
U.S. House of Representatives
Room 2367 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The Bank Lessors Group is an ad hoc group of bank affiliated leasing companies that was formed to monitor legislative and regulatory developments affecting leasing activities of federally regulated banking organizations. Arnold & Porter serves as counsel to the Bank Lessors Group.

The Bank Lessors Group is pleased to submit the attached written testimony in support of H.R. 4494 to clarify that bank leasing companies and other financial institutions whose activities do not cause or contribute to environmental contamination are exempt from liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. The Bank Lessors Group commends the Committee on Small Business for holding hearings on this important legislation.

Sincerely,

Melanie Fein
Melanie L. Fein

Enclosure

Testimony by

The Bank Lessors Group

on H.R. 4494

Submitted to the
Committee on Small Business
U.S. House of Representatives

June 27, 1990

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Testimony by the Bank Lessors Group

on H.R. 4494

Submitted to the
Committee on Small Business
U.S. House of Representatives

June 27, 1990

The Bank Lessors Group is an ad hoc group of bank affiliated leasing companies that was formed to monitor legislative and regulatory developments affecting leasing activities of federally regulated banking organizations.[1]

The Bank Lessors Group is pleased to submit this written testimony on H.R. 4494 introduced by Congressman LaFalce to clarify that financial institutions whose activities do not cause or contribute to environmental contamination are exempt from liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA"). The Bank Lessors Group commends the Committee on Small Business for holding hearings on this important legislation.

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[1] The Bank Lessors Group includes leasing companies affiliated with the following banks: Bank of New York, Bank of Tokyo, Chase Manhattan Bank, N.A., Citibank, N.A., Continental Bank, N.A., First National Bank of Boston, Mellon Bank, N.A., NCNB Texas National Bank, Pittsburgh National Bank, Security Pacific National Bank, U.S. National Bank of Oregon.

H.R. 4494 would specifically exempt banks and other financial institutions from CERCLA liability resulting from the acts of others in connection with certain commercial lending, trust, and leasing activities. The Bank Lessors Group strongly supports this legislation as necessary to clarify the exempt status of regulated financial institutions in accordance with the original intent of Congress in enacting CERCLA.

The Bank Lessors Group particularly supports the provision in H.R. 4494 that would exempt bank affiliated leasing companies that acquire ownership of property in connection with a lease subject to regulation by federal or state banking authorities. Although the legislative history of CERCLA demonstrates that such lease financing activities were intended to be exempt under CERCLA, recent court decisions and actions by the Environmental Protection Agency have raised considerable doubt as to whether such activities are protected in fact.

Under some interpretations of the law, bank leasing companies may be exposed to significant potential liability under CERCLA as a result of holding title to property and equipment solely for the purpose of financing the acquisition and use of such property and equipment by third party lessees. In the attached appendix, we review the relevant case law under which bank leasing companies have become vulnerable to CERCLA liability for the acts of their lessees or others.

In a typical lease financing, the customer will select specific property or equipment for use in its business operations. For tax and other business reasons, the customer may choose to acquire the property by leasing it rather than purchasing it. As a means of financing the acquisition of the property for lease, the customer will request a bank to purchase the property and lease the property to the customer. In other cases, the customer may wish to engage in a sale and lease back of existing assets in order to raise additional funds for working capital and will request bank lease financing.

In order to achieve the desired tax and other benefits of the transaction, the bank will hold title to the property but, during the term of the lease, as in a lending transaction, will not possess or have any other interest in the property other than as collateral. The lessee typically will operate, manage, maintain, possess, and insure the property as if it were the owner of the property. Indeed, under federal banking laws, bank leasing companies may not operate or manage leased property and are prohibited from providing any maintenance, servicing, or insurance of leased property during the lease term. See 12 C.F.R. 7.3400 and 12 C.F.R. 225.25(b)(5).

Bank lessors typically will seek to protect themselves from CERCLA liability by the same precautionary testing, evaluation, representations and warranties, monitoring, and inspection which may be required of a borrower by a lender. Nevertheless, there is no assurance to the lessor that contamination of equipment or a facility may not be overlooked or concealed.

Although leasing companies may be eligible in some circumstances for the "innocent landowner" exemption under CERCLA, that exemption has been very narrowly construed in the case law to date and does not apply to leases of personal property. Moreover, while a bank lessor certainly should be entitled to the "security interest" exemption under CERCLA because it holds title to leased property primarily to secure its interest in the property, the courts to date have not recognized this exemption for leasing activities under CERCLA, and the Environmental Protection Agency has argued strenuously for a very narrow reading of the "security interest" exemption. Thus, bank lessors may be exposed to significant potential CERCLA liability if Congress does not act to clarify the law.

The Committee has heard dramatic and convincing evidence that bank lenders may be unwilling to provide financing to small businesses located in areas where a possibility of hazardous waste contamination exists or may be reluctant to lend to small businesses to finance industrial facilities due to potential CERCLA liability. For many of the same reasons, bank leasing companies are becoming unwilling or reluctant to provide lease financing to certain types of lessees or for certain types of property and equipment without clear CERCLA protection.

Leasing is a common method of financing used by small businesses. According to the American Association of Equipment Lessors, about one-half of all equipment leasing transactions in 1989 were for amounts of $25,000 or less. It is these small transactions that are most affected by the threat of CERCLA liability. A bank lessor must weigh the possibility that a $25,000 equipment lease may result in several million dollars of environmental liability. While a large transaction may justify the additional costs necessary to evaluate the environmental risks of a leasing transaction, lessors are increasingly concluding that, where there is any chance of environmental liability, the risks of small equipment leases simply outweigh the benefits. Consequently, bank lessors are becoming increasingly reluctant to finance such transactions. Small businesses which handle equipment with potential environmental risks find themselves increasingly without access to lease financing. From a public policy point of view, a CERCLA exemption for lease financing activities is appropriate to prevent CERCLA from impeding the ability of small businesses to obtain lease financing.

Lease financing has become a major substitute for commercial lending during the past twenty years and is an increasingly important part of the business of banking.[2] More new equipment is financed in the United States through leasing than through any other financing means except the bond market. In 1989, approximately $130 billion in new equipment was financed by leasing transactions. Bank leasing companies acted as lessors in approximately 30 percent of these transactions.

The threat of substantial and unpredictable liability under CERCLA not only inhibits bank leasing transactions with certain classes of customers but also poses increased risk of loss to the federal deposit insurance system. A bank leasing company that incurred major CERCLA clean-up costs could be forced to look to its parent bank or bank holding company for funds to pay the liability, thereby weakening the entire banking organization and increasing the potential liability to the federal insurance fund. The amount of CERCLA costs imposed on a leasing company would not be limited by the company's size or the amount of the lease by which it acquired ownership to the contaminated property.

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[2] A lease is regarded as the functional equivalent of an extension of credit for purposes of federal bank lending laws. See 12 C.F.R. 7.3400(g); 12 U.S.C. 84, 371c.

The legislative history of CERCLA indicates that Congress intended to provide an exemption for lease financing activities. The definition of "owner" was stated to exclude persons possessing indicia of ownership in connection with a leasing transaction:

> Owner . . . does not include certain persons possessing indicia of ownership (such as a financial institution) who, without participating in the management or operation of a . . . facility, hold title either in order to secure a loan or in connection with a lease financing arrangement under the appropriate banking laws. For example, a financial institution which held title primarily to secure a loan but also received tax benefits as a result of holding title would not be an "owner" as long as it did not participate in the management or operations of the . . . facility. (Emphasis added.)

1980 U.S. Code Cong. & Ad. News 6119, 6181-82, quoting from H.R. No. 96-172, 96th Cong., 2d Sess. 36-37 (1980). Nevertheless, leasing companies have been identified by the Environmental Protection Agency as potentially liable parties under CERCLA for environmental clean-up costs where the lessor apparently had no role in the operation, management, or supervision of the leased property or equipment. See Voluntary Purchasing Groups Inc. v. EPA, 889 F.2d 1380 (5th Cir. 1989).

Congress recognized the limited role that lessors play in financing equipment and other property when it exempted them from liability in connection with nuclear incidents in the Price Anderson Amendments Act of 1988. That Act provides that

> No person under a bona fide lease [of a nuclear facility] . . . shall be liable by reason of an interest as lessor . . . for any legal liability arising out of or resulting from a nuclear incident resulting from such facility unless such facility is in the actual possession and control of such person at the time of the nuclear incident . . . .

42 U.S.C. 2210. For the same reasons that Congress exempted leasing companies from liability under the Price Anderson Act, such companies should be exempt under CERCLA.

H.R. 4494 would relieve bank leasing companies and other financial institutions from unwarranted CERCLA liability without lowering overall environmental protection standards. Leasing companies will continue to require lessees to observe strict precautionary measures to avoid environmental hazards in order to protect the underlying collateral to which they hold title. By making borrowers and lessees bear the financial burden of CERCLA liability rather than sharing such liability with an innocent "deep pocket" financial institution, H.R. 4494 will increase the incentives for borrowers and lessees to employ better safeguards in their handling of toxic materials.

Moreover, H.R. 4494 would protect bank leasing companies only if they are not responsible for causing or contributing to environmental contamination. If a bank leasing company is found to have caused or contributed to contamination subject to CERCLA clean-up, it will not be relieved of CERCLA liability under the bill. Bank leasing companies, as other exempt lending institutions, would continue to bear the cost of CERCLA clean-ups for which they are responsible.

Based on the foregoing, the Bank Lessors Group strongly supports H.R. 4494 as necessary to clarify the protected status of bank-affiliated leasing companies by providing a clear exemption from CERCLA for such companies that do not cause or contribute to CERCLA contamination.

MORTGAGE BANKERS
ASSOCIATION OF AMERICA

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June 22, 1990

The Honorable John J. LaFalce
Chairman
Committee on Small Business
United State House of Representatives
2367 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

The Mortgage Bankers Association of America (MBA) appreciates this opportunity to present its views on HR 4494, "to amend the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 to limit the liability under the Act of lending institutions which acquire facilities through foreclosure or similar means and corporate fiduciaries administering estates or trusts." We strongly support this measure and are appreciative of your efforts on this issue.

The enclosed statement focuses on recent developments in the area of environmental lender liability and in particular, the adverse impact of a recent court decision, U. S. v. Fleet Factors Corp. Case No. 89-8094, slip op (11th Circ. May 23, 1990) on lenders' potential liability under Superfund. Our comments also review current efforts by lenders to determine the presence of environmental hazards on real property as well as the steps the real estate industry has taken to develop an industry standard for environmental assessments. These assessments are important in identifying the presence of environmental hazards on properties, and may also serve as a guide for lenders and other parties who seek to qualify for the "innocent landowner defense," which was included in the most recent reauthorization of Superfund.

Restoring the Superfund exemption from liability for lenders will not remove incentives for lenders to identify environmental hazards on real property. While lender's can not serve as environmental policemen, lenders will continue to play an important function in determining the presence of environmental hazards. Detection of environmental pollutants will remain necessary, as the presence of these hazards dramatically affects the value of the property which serves as collateral for real estate loans.

Legislative action on HR 4494 is a priority for the MBA, and we commend the Chairman and the Members of the Committee for their leadership in formulating legislation to redress the problem of lender liability under Superfund. We also thank the Chairman for clarifying HR 2085, and reintroducing the bill in its current form to cover all mortgage lenders. The MBA believes that HR 4494 will provide important clarification to the courts and other parties regarding lenders' responsibilities under Superfund.

We look forward to working with you on this matter and would be happy to respond to any additional requests. Please contact Ann Hadley vom Eigen (861-6977) of my staff if MBA can be of further assistance.

Sincerely,

Michael J. Ferrell

MJF:ave/gbf

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STATEMENT OF

THE MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

COMMITTEE ON SMALL BUSINESS

of the

UNITED STATES HOUSE OF REPRESENTATIVES

Hearings on

HR 4494, To amend the Comprehensive Environmental Response,
Compensation Liability Act of 1980 to limit the liability
under the Act of lending institutions acquiring
facilities through foreclosure or similar means and corporate
fiduciaries administering estates or trusts

June 7, 1990

The Mortgage Bankers Association of America (MBA)* appreciates the opportunity to present its views on HR 4494, which amends the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA," commonly known as "Superfund") to address the issue of lender liability under Superfund.

MBA supports a national commitment to protecting the environment and the public health from the deleterious effects of pollution and hazardous substance contamination. The effort to clean up existing contamination and to prevent future contamination is an important public goal of society.

Nevertheless, MBA strongly supports HR 4494, which would exempt from Superfund liability those lenders who do not actually contribute to contamination of a property. We believe that this exemption was originally intended by Congress.

The original Superfund statute, enacted in 1980, excluded from liability secured creditors, i.e., a person who "without participating in the management of a...facility, holds indicia of ownership primarily to protect his or her security interest in the facility" (Section 101 (20)(a)). However, as highlighted below, this statutory exclusion of lenders from liability under Superfund (known as the secured creditor exemption) has been seriously eroded by the Federal courts in recent years. MBA believes legislative action restoring the exclusion for lenders is urgently needed to provide guidance to the courts, and to discourage parties who see lenders as convenient deep pockets from bringing law suits against lenders who do not cause or contribute to contamination. Enactment of HR 4494, therefore, is a critical goal for mortgage bankers and other lenders.

We commend the Chairman and the Members of the Committee for their leadership in formulating legislation to redress the problem of lender liability under Superfund, and in continuing to refine the legislation to reflect current legal developments. MBA is particularly grateful for the Chairman's efforts to revise HR 2085, the lender liability legislation introduced last year, to extend coverage to include within the definition of designated lending institutions "any mortgage lender."

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* The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of housing and other real estate finance. MBA's membership comprises mortgage originators and servicers, as well as investors, and a wide variety of mortgage industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, selling, and servicing real estate investment portfolios. Members of MBA include:

- Mortgage Banking Companies
- Commercial Banks
- Savings and Loan Associations
- Mortgage Insurance Companies
- Life Insurance Companies
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Banks
- Real Estate InvestmentTrusts

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We understand the Committee will interpret this provision to cover mortgage bankers, insurance companies, and other lenders that play key financing roles in the real estate markets, but who are not usually classified as "lending institutions". Expansion of HR 4494 to include these entities assures that, at least with respect to environmental liability, a level playing field among financial institutions and other lenders may become a reality.

MBA submitted testimony to the Committee last year describing the problems facing lenders attempting to originate loans on properties in the face of Superfund environmental liability and to deal with the problems of foreclosure on loans which are in default and have environmental problems. Since that testimony was filed last August, the chilling effect of environmental liability has become even more pronounced. Court decisions rendered in the last year have made the possibility of lender liability for environmental cleanup even more likely to occur, and have had a chilling effect on lenders' willingness to lend on businesses with significant environmental risk or on commercial real property where environmental hazards may be present. While the trend to require environmental assessments, in connection with commercial real estate loans is apparently growing, it is not yet universal. According to a survey conducted in the fall of 1989 on behalf of Boelter Associates, an environmental consulting firm located in Chicago, slightly over seventy percent of recent commercial and industrial real estate loan transactions had an environmental assessment of some kind. Lenders involved in single family residential transactions typically do not require environmental assessments as environmental hazards are not likely to be present in residential areas, and the cost burden on single family borrowers would be high.

Because our testimony last year focused on a problem that the Committee obviously recognizes, lenders' predicament in facing environmental hazards, our present statement focuses almost exclusively on two recent developments relating to lender liability: the implications of a recent court decision, U.S. v Fleet Factors Corp., Case No. 89-8094, slip op. (11th Cir. May 23, 1990), and initiation of a process designed to formulate guidance on the steps involved in environmental due diligence. The statement also addresses some additional technical issues concerning the language contained in HR 4494 that reflects recent legal developments and additional concerns which have arisen as the extent of the environmental liability question has been more closely examined.

The Impact of the Fleet Funding Case

As noted above, Congress included the secured creditor exemption in the original Superfund statute when it was enacted in 1980 in order to relieve lenders who have not caused or contributed to contamination from liability. However, the courts have interpreted this provision aggressively, and have sometimes held lenders liable for environmental cleanup under Superfund. While previous cases held lenders who became actively involved in business operations liable for Superfund cleanup, the court held that Fleet Factors, a lender, could be held liable as one who participated in the financial management of a facility from which EPA had removed hazardous substances and asbestos containing materials. (emphasis added)

The viability of the secured creditor exemption was first called into question in U.S. v. Maryland Bank and Trust, 623 F.Supp. 573 (D.Md. 1986). The court in Maryland Bank and Trust determined that a bank which had foreclosed on a loan in default was liable because it had become an owner of the property, notwithstanding the secured creditor exemption. In contrast, in U.S. v. Mirabile, 15 Envtl.Rep. (Envt L. Inst.)E.D. Pa. 1985, 20992, the court held that ownership resulting from foreclosure was not sufficient to hold a lender liable, but a lender could be liable as an operator if it participated sufficiently in the management of the property. The Mirabile court granted summary judgment to a lender who had secured the property from vandalism, inquired about the cost of removing some drums, and sought additional purchasers, but the court denied summary judgment to a lender who participated more actively in the operations.

These cases are illustrative of the differences among the circuits. Further, the dicta in the various decisions provide little direction to lenders faced with the practical reality of dealing with a loan which is in default. The Fleet decision, in addition, may in fact, encourage private parties to sue lenders.

The court effectively articulated a new standard for lenders in stating that "a secured creditor may incur ... liability, without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes. The court stated that it would not be necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable -- although such conduct will certainly lead to the loss of the protection of the statutory exeption. The court stated that it would not necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather, a secured creditor will be liable if its involvement with the management of the facility is "sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose." (emphasis added). The court dramatically lowered the threshold of participation in a borrower's affairs that may safely be exercised by a lender. Thus, a lender's most protective option is not to participate at all in any decisions,-- financial or operational-- if it wants to avoid liability.

Prior to this case, lenders could argue the applicability of the precedent set in Mirabile. Under Mirabile, a lender could, without fear of liability, take certain actions to protect its security interest provided that the actions related to financial management, although participation in day-to-day operations of a facility would trigger liability.
The Mirabile decision stated that "Mere financial ability to control waste disposal practices ... is not ... sufficient for imposition of liability." The Fleet decision specifically rejects the Mirabile holding, and as the first Federal appellate court decision on lender liability under Superfund, the Fleet case establishes a much stronger precedent.

In the wake of Fleet, it is not clear what actions lenders may take without fear of liability.

Prior to the Fleet decision, lenders were confident that simply holding security liens collateralized by real property or a security interest in property which were current, would not subject them to Superfund liability. This threat need only be faced when a borrower fell into arrears, i.e., was not current on loan payments. Lenders monitoring loans in their portfolio that were experiencing financial problems could contract for an environmental assessment, and determine, on the basis of that assessment (and other factors), whether foreclosure was an appropriate response. MBA members have in fact, on the basis of such assessments, chosen not to foreclose, but to forfeit their investment in a property rather than subject themselves to potential environmental liability.

Before the Fleet decision, provided that they declined to foreclose and did not become involved in the day to day operations of a borrower, lenders could avoid liability for environmental problems they did not cause. In practice, lenders use the remedy of foreclosure reluctantly, preferring to try to work with defaulting borrowers to cure the defaults and avoid foreclosure. Lenders refer to this activity as a "workout." Loan documents routinely give lenders many powers in workout situations and these powers are routinely exercised. Following Fleet, lenders may find that any actions may subject them to liability.

Thus, it appears that the ability of a lender to make decisions regarding loans in default, i.e., in "workout" situations, will be greatly restricted. The Fleet court states that "Nothing ... should preclude a secured creditor from monitoring any aspect of a debtor's business. Likewise, a secured creditor can become involved in occasional and discrete financial decisions relating to the protection of its security interest without incurring liability."

It is in the public interest to encourage, rather than discourage, lenders to help borrowers with contaminated property to solve their problems constructively, including cleaning up the contamination on their properties. Unless the secured creditor exemption is properly interpreted to protect lenders from liability in workout situations, lenders will be discouraged from ficilitating this public interest.

The decision reaches far beyond a reasonable interpretation of the statute and the practical realities of the financing business. This new test effectively turns lenders into environmental policemen. It could easily be interpreted by the court on remand, or by other courts, to require a lender to investigate the waste treatment system and policies of potential debtors. MBA contends that this role cannot feasibly be performed by lenders, who have little or no expertise in the environmental area.

Lenders' experience to date with environmental assessments shows some variety in accuracy, and even accurate environmental assessments cannot be exhaustive. Assesments can identify risk, but cannot assure that a property is free of contamination. While assessments can serve as a viable tool for identifying environmental hazards present on a site, lenders would be reluctant to rely on those assessments to monitor operations. In addition, some types of businesses, e.g, farming, are by their nature chemical intensive. Oversight of such operations should involve a knowledge of chemical fertilizers and business operations far beyond the financial expertise of a lender. Further, such active oversight could easily expose lenders to legal liability under partnership theory. Balancing these two competing legal responsibilities is a practical impossibility.

Dispite the concerns raised above the decision does include one very positive feature. The statutory language the court referenced in Fleet, to absolve the state and local government of liability from cleanup, is identical to the proposed language of HR 4494, clarifying the exclusion from liability for lenders.

Environmental Assessments

Concerns have been raised that restoring the Superfund exemption from liability for lenders will provide disincentives to lenders to identify environmental hazards on real property and, thus, discourage identification and cleanup of Superfund sites. This perspective fails to reflect economic reality.

The presence of environmental hazards dramatically affects the value of the property that serves as collateral for the loans and the ability of borrowers to pay. Abandoned hazardous waste sites can occur on vacant or even occupied property, or result from prior legal uses, such as underground storage tanks. Sites can be found anywhere, ranging from what to the eye of the beholder is an open field, to an already occupied downtown office building that was constructed on a site previously used for manufacturing a century ago. The possibility of finding hazardous waste sites on properties, and consequent potential Superfund liability, therefore potentially affects all properties. While there is obviously a relatively higher risk in lending to certain types of businesses, such as chemical manufacturers or waste disposal facilities, the risk of Superfund liability extends far beyond environmentally sensitive operations.

If contamination is discovered in a property serving as collateral for a loan, the borrower is likely to encounter unanticipated cleanup costs. Those costs are likely to be significant enough to impact the cash flow from a property and force a borrower to default on its loan. Under existing court interpretations of Superfund, a lender would be faced with a Hobson's choice. The lender must either write off investment in the property, or risk liability for the entire cleanup cost by becoming involved in a workout. The cleanup cost may well exceed the lender's investment in the property, and the value of the property. Even if HR 4494 is enacted, lenders will avoid originating loans on contaminated property. If the borrower is forced into default by cleanup costs and the lender forecloses, the lender is unlikely to find a buyer for the property; instead the lender will have a contaminated property in its portfolio. Consequently, even with enactment of HR 4494, enormous pressure to identify environmental hazards remains.

Environmental assessments can also be used to attempt to qualify for the "innocent landowner" defense created by an amendment to the Superfund Amendments and Reauthorization Act of 1986 (SARA). That amendment specified that an "innocent landowner" who "did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in or at the facility," would not be liable. To qualify for this defense, "innocent landowners" must have..." undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice." At present, it is unclear what "inquiry" is "appropriate" to enable a party to take advantage of the defense.

While environmental assessments can prove valuable in identifying environmental hazards, they are expensive and not infallible. Most often, environmental assessments are conducted in phases with subsequent, more intensive assessment occurring only if dictated by what is identified in the first phase. The cost of environmental assessments can run from a low of approximately $2,000 to many tens of thousands of dollars. Although the absence or presence of contamination is not tied to the value of the transaction, for practical purposes a small transaction cannot bear the same costs as a large transaction: a loan on a $750,000 garden apartment building cannot bear the same assessment costs as a loan on a multi-million dollar, office building. Moreover, even when the value of the transaction justifies greater expense, there will always be unknown risks. Consequently, we are concerned that the term "appropriate inquiry" in the innocent landowner defense provided by Congress in SARA not be interpreted so as to impose unrealistic standards of inquiry on property owners and lenders.

There is little useful judicial or regulatory guidance as to the meaning of the inquiry required to qualify for the innocent landowner defense. While this provision could be interpreted to benefit a lender, a lender must also exercise due care upon the discovery of the contamination.

The viability of environmental assessments in qualifying for the innocent landowner defense as tested in the courts, has yielded varying results. In Int'l Clinical Lab.Inc. v. Stevens, Case No. CV 87-3472, slip op. (E.D.N.Y. Jan. 11, 1990), the court found that because contamination was not visible on inspection, International Clinical Laboratories did satisfy the innocent landowner defense. On the other hand, in BCW Assoc., Ltd.v. Occidental Chem. Corp., No. 86-5947, (slip. op. (E.D. Pa. Sept. 29, 1988), a purchaser and lessees whose engineering firms reported that the buildings were "free of hazardous waste and contamination", were denied the protection of the innocent landowner defense.

These conflicting court decisions lead to great uncertainty in the lending community regarding what specific steps must be undertaken to perform an adequate environmental assessment and qualify for the innocent lender defense. By calling into question the extent to which lenders may legally rely on the evaluations made by their environmental experts, they accentuate the need for action on HR 4494.

The conflict in the courts is exacerbated by the lack of regulatory guidance on this matter. Many members of the lending community hoped that the EPA would clarify the steps to be undertaken to meet the innocent lender defense. However, the EPA "Guidance on Landowner Liability under Section 107(a)(1) of CERCLA, De Minimis Settlements under Section 122(g)(1)(B), and Settlements with purchasers of Contaminated Property", (June 6, 1989), provides little substantive help on the issue. The guidance document merely indicates that the lender will be potentially liable, if it forecloses and takes title or conducts management activities; that commercial owners will be held to a higher standard than residential (which was already clear from SARA's legislative histroy); and that determinations of appropriate inquiry would be made on a case-by-case basis.

Consequently, MBA is actively participating in a process sponsored by the American Society of Testing Materials, which is designed to develop a voluntary industry standarsd that would specify the steps to be undertaken to constitute "all appropriate inquiry". We hope that this process can be completed in early 1991 and that this product will be a useful means for determining not only the extent of environmental contamination on a property, and the consequent effects on human health (as well as the value of the property), but also the specific elements of a due diligence defense.

Even if this due diligence protocol is developed and adopted by the industry, the lending community would continue to advocate addressing the problem of lender liability under Superfund through HR 4494. Due diligence serves to identify environmental hazards and may provide a legal defense. The assurance provided by the provisions of HR 4494 far exceeds the protection supplied by a legal defense which must be asserted in court. Enactment of HR 4494 will provide a clarification and restatement of Congressional intent regarding lender liability that will send signals to the courts, the business community, and parties who view bankers and lending entities as deep pockets, that innocent lenders should not be held liable under Superfund.

Technical issues

MBA commends the Chairman for revising the legislation originally introduced to address many of our members concerns. The sophistication of the financial markets and lending transactions, and the proactive interpretation and rapidly evolving legal theories of the courts suggest new issues that the legislation should address. These revisions, which could be addressed in either revised bill language or in the committee's report accompanying the legislation, are summarized briefly below.

Workouts

MBA believes that the legislation does clarify that lenders who have foreclosed would not be liable for Superfund liability. However, the new test, articulated in Fleet, raises serious issues concerning potential treatment of lenders' activities with respect to financial management of problem loans and of all outstanding real estate loans. It would be helpful for the Committee to indicate (1) that the exemption from Superfund liability for lenders provided in HR 4494 specifically rejects the assumption in Fleet that lenders must act as environmental police officers and bear the liability of their borrowers for contamination they did not cause; and (2) that, instead, lenders who become involved in workouts or in supervising loans not in default may exercise their rights over financial matters of the borrower without fear of liability and may even take steps to encourage borrowers to handle contamination responsibly without fear of liability. This clarification could be made with reference to the term "control" in Section (a)(1)(A)(i), on Line 9 of page 2. It is in the public interest for lenders to encourage borrowers to handle contamination responsibly, and this kind of a clarification will allow them to do so without fear of liability.

Definition of Release

We strongly support the exception to the exemption provided in HR 4494 for lenders who contribute to contamination: certainly lenders who contribute to contamination should be liable. However, we fear that the court have expansively interpreted the phrase "contributed to the release," so that any actions taken by lenders can be interpreted a "causing or contributing to a release". Provisions specifying that lenders may exercise "due care" in addressing environmental hazards may prove helpful in allowing lenders to take action on environmental problems.

Extent of Exclusion

The definition of lender in HR 4494 has been substantially expanded to include "mortgage lenders", which we believe will shield mortgage bankers, the real estate departments of insurance companies, and other lenders from Superfund liability. We remain concerned that the "floor" of 25 loans established in the legislation is too low. A floor of five would eliminate those not in the business of making loans without excluding those who are in the business of making loans. Many state licensing laws set a "floor" of 10 loans for residential lenders. Many commercial real estate lenders make fewer than 25, and even fewer than 10 loans in some years. In addition, the Committee should clarify that the exemption applies to lenders who did not originate the loan. In Abcor, Inc. V. State Street Bank and Trust Co., D.C. Mass Case No. 88-1324-K, August 21, 1988 for instance, a lender who acquired a loan through a merger, has been sued and has agreed to pay 17 percent of the total liability for cleanup.

Many residential real estate loans are originated by mortgage bankers who close loans in their own names, but immediately sell the loans to others. These lenders are technically in the chain of title, but can have no practical effect on the financial management of the loan either at origination, or on an ongoing basis. Prior to the Fleet decision, MBA would not have assumed that courts would reach back to such an extent and hold such lenders liable. However, given the dicta in Fleet, we believe it would be worthwhile for the Committee to address those lenders who participate in loan servicing or placement.

Consequently, extension of the exemption to lenders who acquire and service loans would prove helpful.

MBA appreciates the efforts of the Committee to address this issue, and its continuing efforts to revise the legislation to address current concerns. We look forward to working with the Committee to refine HR 4494 further and to assure enactment of legislation that will prohibit the courts from imposing liability on innocent lenders. We would be happy to respond to requests for additional information. Please contact Ann Hadley vom Eigen of my staff on 861-6977 if you have any questions.

NAFCU

NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS
P.O. BOX 3769 WASHINGTON, DC 20007
(703) 522-4770

June 7, 1990

The Honorable John J. LaFalce
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515-6315

Dear Mr. Chairman:

I am writing you regarding the committee's hearings today on the issue of lender liability under the Superfund Act, and ask that this letter be included in the hearing record.

On behalf of the National Association of Federal Credit Unions -- the only national organization exclusively representing the interests of credit unions chartered by the federal government -- I wish to commend you, Mr. Chairman, for calling these hearings today and the dogged determination you have displayed on this issue. Your dedicated efforts in this area and sponsorship of legislation to restore the original intent of Congress to protect innocent landowners/lenders from Superfund liability have earned you the appreciation of credit unions nationwide.

As you know, Mr. Chairman, a series of recent court cases have extended liability under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 -- more commonly known as the Superfund Act -- to mortgage lenders who acquire contaminated property through foreclosure even though the lender had no reason to know of the contamination at the time it entered into the lending agreement and did nothing to exacerbate the problem afterwards. This judicial extension of liability has occurred despite the fact that the Superfund Act prescribes an innocent landowner defense to liability to parties who had no knowledge of the contamination prior to possession of the property and did nothing to cause or release the hazardous substance after acquiring possession.

It is difficult to find the appropriate words to express the degree of unfairness embodied by these judicial interpretations of the law. We can think of no sound public policy basis for holding creditors liable for borrower misdeeds. Under these recent court decisions, a creditor not only incurs the risk of losing mortgage collateral, but also faces the potential of having made a relatively small loan and owing much greater sums for a Superfund cleanup. Furthermore, and even more incredibly, this liability appears to transfer to the federal deposit insurance funds if a federally-insured lender fails as a result of unwittingly assuming the cleanup responsibility.

Because of the immense cost of Superfund cleanups, only one significant incident of this nature could put a credit union into insolvency and threaten the safety and soundness of the National Credit Union Share Insurance Fund. Even though federal law prohibits federal credit unions from engaging in commercial real estate lending, it is possible to foresee a circumstance under which a federal credit union could suffer liability under the Superfund Act; one need only look to the tragedy of Love Canal to realize that contaminated properties are not limited to industrial real estate.

Mr. Chairman, NAFCU wholly agrees with your assessment that Congress did not intend to hold liable innocent lenders when it enacted the Superfund laws in 1980 and 1986. For this reason, NAFCU strongly supports H.R. 4494 to restore the original intent of Congress to protect innocent lenders from Superfund liability, and commend your vigorous efforts to correct this inequity.

Sincerely,

John M. Stanton

John M. Stanton
Chairman

JMS:dt

National Association of Home Builders
15th and M Streets, N.W., Washington, D.C. 20005
Telex 89-2600 (202) 822-0200 (800) 368-5242

Martin Perlman
1990 President

June 5, 1990

The Honorable John J. LaFalce
U.S. House of Representatives
2367 Rayburn House Office Building
Washignton, D.C. 20515

Dear Representative LaFalce:

On behalf of the 157,000 member firms of the National Association of Home Builders, I would like to thank you for your leadership in introducing HR 4494, which would restore the intent of Congress to provide innocent lenders an exclusion from Superfund liability.

In endorsing this legislation, our Board of Directors noted that thousands of home builders are finding financing harder to obtain because of court decisions that have narrowed the specific exclusion from Superfund liability Congress gave to lenders. In this regard, we have been working with lenders in encouraging support for your bill from real estate groups and other members of Congress.

However, our Board also noted that your legislation addresses only one part of the Superfund liability problem since home builders may still be liable for cleanup costs due to the lack of standards by which home builders can qualify for the innocent landowner defense.

As you know, in 1986, Congress created a defense to the cleanup liability for innocent landowners if the purchaser "did not know and had no reason to know" that the site was contaminated. To qualify for this defense, the land purchaser "must have undertaken, at the time of the acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practices." However, no such standard exists within the real estate, banking or consulting engineering industries. Moreover, Congress, the courts and EPA have yet to establish what actions will satisfy the appropriate inquiry standard for the innocent landowner defense.

At this time, NAHB is working with numerous industry groups, environmental consultants and government representatives to develop voluntary standards for "good commercial or customary practices" through the American Society of Testing and Materials (ASTM). I will keep you aware of progress in this regard and whether Congress will need to address this additional area of potential Superfund liability.

Again, thank you for your leadership on this issue and your untiring support for small businesses and their concerns before Congress.

Best Personal Regards,

Martin Perlman

NATIONAL ASSOCIATION
OF REALTORS®
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June 13, 1990

The Honorable John J. LaFalce
2367 Rayburn House Office Building
Washington, DC 20515

Dear Representative LaFalce:

On behalf of the more than 800,000 members of the NATIONAL ASSOCIATION OF REALTORS®, I would like to take this opportunity to thank you for your leadership in addressing H.R. 4494. That legislation would amend the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) to limit the liability under that Act of lending institutions acquiring facilities through foreclosure or similar means and corporate fiduciaries administering estates or trusts.

Throughout this Nation, many potential property owners are experiencing difficulty in obtaining financing sources for lands due to court interpretations that have narrowed the Congressionally mandated lender exclusion from Superfund. We have joined forces with several real estate and lending groups to support your legislation, H.R. 4494, and re-establish the lender liability exemption.

Lender liability, however, is only part of the problem facing buyers. Property owners may still be considered liable for clean up costs due to the lack of definition for "all appropriate inquiry into previous ownership and uses" under Superfund. Under that standard, a property owner must conduct all appropriate inquiry at the time of acquisition of a property if they are not to be held liable for future clean up costs for contamination they had no knowledge existed prior to the purchase. This is known as the innocent landowner defense.

While this innocent landowner defense clearly exists within the framework of Superfund, there has yet to be established a defensible standard for all appropriate inquiry. Currently, no such standard exists within the real estate, lending, or consulting industries. In an effort to clarify and create a voluntary, industry standard, the NATIONAL ASSOCIATION OF REALTORS® has been an active participant in the American Society of Testing and Materials consensus group involving environmental consultants, government, lenders, and the real estate industry to develop these voluntary standards.

REALTORS® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

Thank you for your consideration of this issue of vital importance to the NATIONAL ASSOCIATION OF REALTORS®. We look forward to working with you and your staff on the bill H.R. 4494, and the innocent landowner defense.

Sincerely,

Norman D. Flynn

Norman D. Flynn

USL
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J. DENIS O'TOOLE
Executive Vice President
for Government Affairs/Operations

June 21, 1990

The Honorable John J. LaFalce
Chairman
Committee on Small Business
2361 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman LaFalce:

On behalf of the members of the United States League of Savings Institutions, we wish to offer the following comments and suggestions in support of H.R. 4494. Since savings institutions are major real estate lenders in every state, the U.S. League and its member institutions are affected by the Comprehensive Environmental Response Cooperation and Liability Act (CERCLA), and we are concerned about the liability of our members for the costs of cleaning up hazardous waste in situations where the lender in no way caused or contributed to the contamination. Therefore, we want to express to you our appreciation for the introduction of this legislation to clarify and rationalize the legal position of lenders with regard to the costs of hazardous waste cleanups under the Superfund law.

The testimony received by the Committee during its June 7, 1990, hearing well documented the case for legislative action to perfect the Federal Superfund statute. While we very much endorse the positions taken by the several lenders who testified, there is one other issue that we want to highlight for the record.

As you know, Mr. Chairman, all federally related depository institutions have a statutory obligation under existing Federal law to "meet the credit needs of their communities." This obligation is spelled out in the Community Reinvestment Act (CRA), which was amended and made more forceful less than a year ago as a part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

THE AMERICAN HOME THE SAFEGUARD OF AMERICAN LIBERTIES

There is no leeway in CRA for environmental liability considerations. Conversely, there is no exemption from "lender liability" for loans made to communities with special credit needs.

The U.S. League and its member institutions have a long standing tradition of community oriented lending, and saving institutions take seriously their responsibility to comply with the Community Reinvestment Act. In the past decade, savings institutions have recognized in their loan underwriting standards that protection and enhancement of the environment is a public policy goal that is of increasing importance to the American people and their communities. Unfortunately, one of the real life dilemmas that confronts many lenders is the fact that many of the sites best suited for industrial or commercial development by small businesses are properties that were previously used for purposes where hazardous waste contamination might have occurred.

Consider, if you will, the dilemma faced by a community lender by the confluence of two, well-intended, federal laws. A minority developer applies for a bank loan to acquire an abandoned commercial site to build a new, small business. The lending officer reasonably surmises that environmental damage may have occurred to the site due to the business use of the land by prior owners. However, for both the developer and the community, development of the abandoned commercial site is economically important to the community and an economic necessity for development of the project. If the loan is approved, the bank is meeting the congressionally mandated goals of CRA, but may be exposing itself to significant financial liabilities for the cost of a hazardous waste cleanup under the Superfund law. If, on the other hand, the bank denies the loan on the basis of the potential for hazardous waste contamination, then the CRA obligations are unmet with resulting negative community reaction and potential criticism from the federal banking examiners.

Mr. Chairman, the dilemma described above can be reasonably minimized. The enactment of H.R. 4494 will eliminate this "no win" choice for most lenders and small business borrowers. The legislation will clarify the intent of Congress that the Superfund's liability exemption should broadly include most mortgage lending situations where the lender has title or control over contaminated property through the perfection of a secured mortgage interest.

We respectfully request that this letter be made part of the record from the June 7 hearing on H.R. 4494. We appreciate your leadership and hard work on this issue and stand ready to assist you and your Committee in any way we can.

Sincerely yours,

J. Denis O'Toole

J. Denis O'Toole

cc: Rep. Joseph M. McDade
Ranking Republican Member

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